Exiting Intellectual Grooves in the Reporting of Liabilities

(An Analysis of the Reporting of Liabilities under Chambers’ Continuously Contemporary Accounting)

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A thesis presented in fulfilment of the requirements for the Degree of Doctor of Philosophy in The University of Sydney.
The University of Sydney

Faculty of Economics and Business

Candidate's declaration

I hereby declare that this thesis, entitled 'Exiting Intellectual Grooves on the Reporting of Liabilities' and submitted for the degree of Doctor of Philosophy, contains no material that has been accepted for a degree or diploma at any other university or tertiary institution. This work, to the best of my knowledge and belief, contains no material previously published or written by another person except where due reference has been made in the text and bibliography.

Signed: ........................................

Date: ...........................................
Dedication

This project was carried out first for Joseph Aloysius and Eileen Mary, my previous generation; second, for Monica Mary and Bernard Basil, of my generation; third, for John Benedict and Vanessa Elizabeth, my future generation.
# Table of Contents

Abstract                                                                                           i  
Acknowledgements                                                                                   iv

## Chapter 1 Introduction

1.1 Background                                                                                       1  
1.2 The Chambers Collection                                                                           3  
1.3 Framework for Analysis used in the Study                                                          4  
1.4 Justification of the Study                                                                         7  
1.5 Objectives and Plan of the Study                                                                8  
1.6 Limitations of the Study                                                                         10

## Chapter 2 The Framework: Corporate Governance before the Twentieth Century - the Dominant UK Influence

2.1 Introduction                                                                                      13  
2.2 A brief history of Reporting in Corporate Governance                                              15  
2.3 Before the Eighteenth Century
    2.3.1 The USA scene                                                                                 20  
    2.3.2 Accounting interactions                                                                       21  
    2.3.3 Reporting of liabilities                                                                     21

2.4 The South Sea Company, the “Bubble’ and its Aftermath
    2.4.1 The USA scene                                                                                 26  
    2.4.2 Accounting interactions                                                                       28
    2.4.3 Reporting of liabilities                                                                     29

2.5 The Gladstone Committee of 1841-1844 and Early Companies Acts
    2.5.1 The USA scene                                                                                 34
    2.5.2 Accounting interactions                                                                       36
    2.5.3 Reporting of liabilities                                                                     38

2.6 The Excesses of the Late 1800s
    2.6.1 The USA scene                                                                                 41
    2.6.2 Accounting interactions                                                                       47
    2.6.3 Reporting of liabilities                                                                     48

2.7 Summary and Conclusions                                                                          48

## Chapter 3 The Framework: Corporate Governance in the Twentieth Century Until World War I – The Dominant USA Influence

3.1 Introduction                                                                                      53

3.2 Theodore Roosevelt & the Populist Movement
    3.2.1 The UK scene                                                                                 63
    3.2.2 Accounting interactions                                                                       65
    3.2.3 Reporting of liabilities                                                                     71

3.3 World War I and the Aftermath
    3.3.1 The UK scene                                                                                 76
    3.3.2 Accounting interactions                                                                       79
    3.3.3 Reporting of liabilities                                                                     81

3.4 Summary and Conclusions                                                                          82
Chapter 4 The Framework: Corporate Governance in the Twentieth Century

Between the World Wars – The Dominant USA Influence

4.1 Introduction
4.2 The Excesses of the 1920s
   4.2.1 The UK scene
   4.2.2 Accounting interactions
   4.2.3 Reporting of liabilities
4.3 Franklin Roosevelt and the New Deal
   4.3.1 The UK scene
   4.3.2 Accounting interactions
   4.3.3 Reporting of liabilities
4.4 The May Legacy
4.5 Summary and Conclusions

Chapter 5 The Framework: Corporate Governance in the Twentieth Century

From World War II to the 1950s – The USA Influence

5.1 Introduction
5.2 World War II and Post-Developments
   5.2.1 The UK scene
   5.2.2 Accounting interactions
   5.2.3 Reporting of liabilities
5.3 Australian Experiences & Chambers’ Early Writings
5.4 Summary and Conclusions

Chapter 6 Saturation: Corporate Governance in the Twentieth Century - Developments of the 1950-1960s

6.1 Introduction
6.2 The questionings of the 1950-1960s
   6.2.1 The USA scene
   6.2.2 The UK scene
   6.2.3 The Australian scene
6.3 Chambers’ 1966 *Accounting, Evaluation and Economic Behavior*
   6.3.1 Insights from the Collection
6.4 Related Debates and their Resolution
   6.4.1 The Influence of Interdisciplinary Studies
   6.4.2 Accounting and Accountability
6.5 Summary and Conclusions

Chapter 7 Incubation: Conceptual Framework Projects and Other Diversions

7.1 Introduction
7.2 The Conceptual Framework Projects of the 1970s *et seq*
   7.2.1 Insights from the Collection
   7.2.2 The Australian CF
   7.2.3 True and Fair View Revisited
   7.2.4 The IASB Framework
   7.2.5 CF Projects & Accounting Standards
7.3 Social Reporting
7.4 Summary and Conclusions
Chapter 8 Incubation – Definition, Recognition and the Valuation Methods

8.1 Introduction 254
8.2 Terminology for the Element – Liability 255
8.3 The Uses of the Term ‘Value’ 258
8.4 The valuation methods/Measurement 263
  8.4.1 In general 263
  8.4.2 In accounting 268
    8.4.3 Conceptual framework developments 274
8.5 Chambers’ CoCoA and liabilities 286
8.6 Hierarchy of Terms and their Measurement 289
8.7 Summary and Conclusions 290

Chapter 9 Illumination - Reporting Liabilities in the 2000s: Progression or Regression?

9.1 Introduction 293
9.2 The analysis of Botosan et al (2005) 295
9.3 Testing the research propositions and requirements for resolving issues for reporting of liabilities 298
  9.3.1 Proposition 1 and liabilities under conventional accounting 298
  9.3.2 Proposition 2 and balance sheet versus financial position 299
  9.3.3 Proposition 3 and the interdisciplinary tensions 300
  9.3.4 Proposition 4 and issues of definition and recognition 303
  9.3.5/9.3.6 Propositions 5/6 and the measurement dilemma 303
9.4 Consequences for the annual report 308
9.5 Chambers, his vision and the future of CoCoA 313
9.5 Summary and Conclusions 315

Appendices 318

I Conceptual Framework - Version 1 319
II Conceptual Framework - Version 2 320
III Conceptual Framework – Chambers’ Version 321
IV Implications for an Annual Report 323
V Glossary of abbreviations and acronyms 333
VI Summary of Arguments 335

Bibliography 341
Abstract

This thesis deals with tensions met in accounting for liabilities. Over the years, those tensions arose in definition, recognition and measurement of liabilities. While once regarded as quite uncomplicated (and requiring little thought), liabilities became most complex as the definition broadened and new financial instruments (both primary and secondary) were created, causing recognition and measurement tensions within accounting. The 21st Century has witnessed continued debate on Equity/Liabilities.

The thesis developed here is that attempts to develop a theoretically sound and practically workable way of accounting for liabilities have been constrained by a recycling of ideas, of being stuck in an intellectual groove. It is argued that to exit that groove requires agreement that tensions follow from the provision of intermingled data — conventional accounting, financial, economic and social — in one report.

The proposal here is any approach to unravel that intermingling must:

- Produce a contemporary statement of financial position,
- Allow for tensions from a mixing of ideas and concepts of an interdisciplinary type,
- Produce an interrelated hierarchy in the definition of terms,
- Accept that values are distinct from prices, and
- Allow for dilemmas met in measurement, including those related to the time factor, markets and models.

Above all else, consideration must be given to

- ‘The total scene’ — one of the major themes of Chambers’ works.

While research in this area may be conducted in distinct ways, here Chambers’ ‘method of construction’ is employed — one which analyses the environment in which accounting for liabilities is placed. Chambers (and others before and after him) claim that to provide a proper method of accounting for elements (including liabilities), one must first establish the function of accounting. It is argued this is to provide financial statements which act as a device to steer or control corporations as well as assisting related decision-making (or what Chambers would term ‘choice’) by stakeholders. Chambers used, among other techniques, a flight instrument navigation analogy to support his required outputs of an accounting system. This is consistent with the use of the term ‘governance’ which may be traced back to early Greek origins. While ‘corporate governance’ is a phrase arguably coined in the late 1980s, the idea is much older. It was certainly discussed in the 1800s in both UK and USA, as shown in Chapter 2.

It is shown that throughout the 19th and 20th Centuries, issues emerged in respect of financial reporting, a category more general than financial statements, resulting in lengthy debate. Chambers saw a link between the reporting of (sometimes misleading) accounting data, (especially that found after unexpected corporate collapses, in mergers/takeovers/amalgamations battles and in the dilemmas met in times of rapid
changes in prices and price levels), and calls for reform of accounting of a conventional type. In Chapter 2, within a context of events in a dominant (in the Anglo-Saxon sphere) UK, it is argued that earlier analysis of companies was generally at a legal level. Later, the advantages of a company format to finance and manage large investment projects led to analysis at an economic level. Towards the end of the 19th Century, a major issue of debate was ‘big business’. In the 20th Century, as USA dominance grew, ‘publicity’ as a control device was debated - times when accounting reports arguably had a stated function. However, it would take a lengthy period to identify what was to be published. In general, the reports were of position and performance (Chapter 3). Control of the contents of these reports was ‘captured’ by the accounting profession, a well-known practitioner George O. May playing a pivotal role. The ‘May legacy’ saw consolidation of allocated historical cost as the foundation of what is referred to as conventional accounting (Chapter 4).

In Chapter 5, the 1940s are identified as times when the corporation’s role moved to the social level. During that time, the May legacy led to tensions, as others sought financial statements of a more relevant, contemporary type. From the late 1940s to the mid-1960s, Chambers developed a rigorous system of financial reporting to help users understand the nuances of financial adaptation. Developed in a series of journal articles, it was published (in its then form) as a book in 1966 - a magnum opus of accounting to external users. Continuously Contemporary Accounting (CCA) was Chambers’ solution. The acronym was later usurped by another system - Current Cost Accounting - and Chambers’ model became known as CoCoA. This model, despite incorporating the works of various scholars and applications from practice, was seen as being novel and quite radical.

The system was quickly attacked by some academics, their students and practitioners. They saw minimal net benefit in adopting the system, preferring instead the status quo of conventional accounting or their own proposals for reform. Other academics, their students and practitioners were to support the model in full or in part. Changes were suggested. One area of contention was to be the treatment of liabilities.

Some debates achieved little; others led Chambers to incorporate changes from his original tenets. Still others were vigorously defended by Chambers. A broadening of any reporting to include economic and social data led to debate, introduced in Chapter 6, that too much was expected of financial statements. To Chambers, this was a key issue. His CoCoA and other works are placed in Chapter 7 within a context of the conceptual framework projects and their historical development. It is argued that the projects have led to tensions by including economic and social data. Chambers’ fundamental ideas are shown to underpin (in principle) developments in the Australia project.

Building on the framework projects worldwide, analysis follows in Chapter 8 of issues of definition, recognition and measurement in general and of liabilities in particular. The definition of liability under CoCoA is quite explicit, as Chambers took an approach consistent with his general accounting theory. His argument does not reject a hierarchy of interrelated terms regarding liabilities. Support is also provided by arguments for economic market-type data and more relatively recent debates regarding social data.
Debate, as shown in Chapters 1 and 9, continues. Chambers’ ‘revolution’, associated with the acronym CoCoA, continues, but at a gradual rate. His arguments regarding liabilities remain very contentious, given moves to ‘fair value’ liabilities. However, benefit-cost analyses of changes in accounting for liabilities include, either explicitly or implicitly, effects of applying issues of the underlying reasoning provided by the tightly structured CoCoA.
Acknowledgments

Professor G W Dean, as supervisor, provided much support and direction in the work leading to this thesis. His detailed knowledge of the literature in general and of the writings of Professor R J Chambers in particular (including the Chambers Collection) was invaluable in the related research. His friendship spans a period much longer than that of this study and remains invaluable.

Over an academic career of some forty years, I have been fortunate to have had guidance and support from academic colleagues, students (some of whom in turn became academics) and other friends from those times. Chronologically, they were from the University of Queensland, the University of Sydney, Kansas University, Lancaster University, the University of New England, Florida International University and Griffith University. Unfortunately, they are too many to be listed, but they were there to provide support in times of academic or personal tribulations. Many thanks are due and readily given to all.

However, it would be most remiss not to single out the two people who turned my previous training into an education while a young academic at the University of Sydney — the late Professor R J Chambers and the late Professor W P Birkett. Both encouraged questioning, wide reading and being adventurous in the cause of academic scholarship and pursuits.

The Accounting Foundation provided support via the R J Chambers’ Scholarship, making the task more manageable. The Faculty of Economics and Business and School of Accounting and Business Law of the University of Sydney provided exceptional working facilities. The staff — academic and administrative — happily provided support when sought. Again they are too many to be listed, but thanks are readily given.

Special thanks are due and given to Ben, Vanessa, Chris and Lynne for assistance when needed, especially when the researcher — who certainly has developed some sympathy with the Luddites — found difficulties in dealing with the new technology of the computer age. Lynne also was instrumental in making the presentation of the work acceptable.

I was fortunate to have access to the Post-graduate Library of the Business School of the University of Queensland, my undergraduate alma mater. As well, staff of the CPA Australia Library was most helpful in willingly chasing up some difficult references.
Chapter 1 Introduction

The past offers us a rich database from which we can learn, in order that we may keep on succeeding.

Issues relating to liabilities have arisen in an array of agenda projects.
FASAC, 2004b, p1.

1.1 Background
This study examines how ‘liabilities’ are included in financial reports. From current issues met worldwide, it is suggested that the treatment of liabilities is one way that preparers of reports are able to implement accounting techniques to ‘manage’ the reporting of position and performance, including those of ‘smoothing’ performance during times of volatility in various markets (Schuetze, 2001, p3-6).

From the public sector, illustrations are provided in the academic literature where debate is found on the reporting of a ‘liability’ for future maintenance – part of the intergenerational dilemma (Walker et al, 2000). In the semi-professional literature, issues regarding liability for pensions are topical in UK (The Economist, 2006d, p59-61), in Japan (The Economist, 2006, p30) and in USA (The Economist, 2006a, p39). The popular literature places under scrutiny the reporting of the effects of fluctuations in exchange rates on actual and potential liabilities by the Australian federal government (O’Loughlin, 2002, p1). It has been suggested accounting techniques have been used to hinder disclosure.

Private sector illustrations (Wolnizer, 2004, p1) are provided by bank-related imbroglios (Gray & Clarke, 2004) as well as in the Australian case of HIH Insurance (Westfield, 2003) and the USA case of Enron (McLean & Elkind, 2003). In the semi-professional literature, tensions regarding liabilities for employee health costs and pensions remain (The Economist, 2006b, p63). In the popular press, Bartholomeusz (2002) writes of the HIH and Enron cases that ‘the companies hid large losses over a period of years and appear to have used questionable accounting practices to disguise the true state of their affairs.’ Hallows (2002) concludes, ‘You simply can’t believe the balance sheets they produce.’

As regards liabilities in the HIH case in particular, Humphries (2002) and Tasker (2002 and 2002a) write of those for claims being misreported, as was the risk related to reinsurance matters. The literature includes the Report from the Royal Commissioner (Owen, 2003) on the failure of HIH Insurance and publications on various topics (Clarke et al, 2003, p222-245). This case is ongoing during the period covered in this thesis.

In the Enron case, Morgenson (2001, p32) writes the ‘crash has shown that very scary liabilities can hide in a set of books.’ She proceeds to describe the results of the ‘off-balance-sheet’ technique whereby management enters into various arrangements so that particular obligations are not disclosed in the entity’s balance sheet, even though the entity may still face contingent liabilities. Again, the reporting of this case is

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1 Particular emphasis is placed on financial reports of corporations listed on a stock exchange.
ongoing. The literature already includes various reports by, for instance, the Securities and Exchange Commission (www.sec.gov).

Recourse to the annals of finance suggests issues like these are not new (Briloff, 1972, 1976, 1982; Chambers, 1973; Clarke et al, 1997, 2003). Why does this recycling persist? It is quite puzzling, especially when examined in the context of the work done from the late 1960s to date on CF projects in various countries which were to ensure that accounting standards are consistent and logically formulated. The CF was also to guide preparers of reports in cases where standards were not yet developed and to enable other users of accounting standards to understand and evaluate actual and proposed standards (Buffini, 2006). This theme will be further examined in Chapter 7.

A contribution of this study is its focus on liabilities – issues of which arguably are less emphasised in accounting research. However, while issues related to assets tend to dominate accounting debates, issues of liabilities are becoming more visible. Another contribution is the focus placed on previously unpublished data to be used to unravel the puzzle as to why in the literature recycling of liability issues continues. Data are primarily from the Chambers' archives and his writings (Section 1.2). Further data will be provided from a broader array of the literature (academic, professional, semi-professional and popular) than normally covered by accounting researchers.

Contributions are placed in a context of accounting reports being used as a monitoring device in a CG framework (Section 1.3, Chapters 2 to 6 inclusive). Within this framework, a series of propositions/research hypotheses\(^5\) are developed for testing using the archival data collected.

\(^2\) Morgenson (2001, p32) continues, 'During the last decade, thousands of companies in many industries have used off-balance-sheet financing to power their expansions. Their obligations range from the mundane payments on leased aircraft or on real estate that is owed by third parties or liabilities associated with operations in which a company has a minority interest to the more arcane, including complex derivatives transactions.'

\(^3\) See for instance Riley (2002); Anonymous (2002); The Economist (2002); Clarke et al, (2003, especially p259-262); McLean & Elkind (2003); The Economist (2006c).

\(^4\) See Sterling's claim (1979, p4): 'Accountants anticipated the ecology movement by some years; instead of disposing of issues, we recycle them.' Earlier, he (1975, p3) lamented, 'We accountants do not resolve issues, we abandon them. I do not mean to imply that we ignore issues. Quite the contrary, we debate them long and loud. However, the debate, instead of coming to a resolution, continues until another issue comes along that is more current and more controversial, and then we forget the former issue.' If writing today, he might easily add 'to resurface decades later'.

\(^5\) See Gay & Diehl (1992, p74): 'Hypotheses are classified as research hypotheses or statistical hypotheses; research hypotheses are stated in declarative form .... A research hypothesis states an expected relationship or difference between two variables; in other words, the relationship the researcher expects to verify through the collection and analysis of data is specified. Research, or declarative, hypotheses are nondirectional or directional. A nondirectional hypothesis simply indicates that a relationship or difference exists; a directional hypothesis indicates the nature of the relationship or difference.'
1.2 The Chambers Collection

A question raised early in discussions of this study is why use historical documents from (say) the R J Chambers Collection (the Collection) in seeking resolution of current debates of social and economic development in general and in accounting in particular. Watson (2001, p8) provides an answer,

The discipline of history is particularly important ... because while science has had a direct impact on how historians write, and what they write about, history has itself been evolving. One of the great debates in historiography is over how events move forward. One school of thought has it that “great men” are mostly what matter, that the decisions of people in power can bring about significant shifts in world events and mentalities. Others believe that economic and commercial matters force change by promoting the interests of certain classes within the overall population.... I would suggest that ... what we have viewed as the causes of social movement in the past ... are both being superseded as the engine of social development. That new engine is science. Science has no real agenda; it cannot be forced in any particular direction. Its necessarily open nature ... ensures that there can only ever be a democracy of intellect in this, perhaps the most important of human activities.... To succeed, to progress, the world must be open, endlessly modifiable, unprejudiced. Science thus has a moral authority as well as an intellectual authority. This is not always accepted.

Inferences regarding research methods in the discipline of history and related historiography are presumed in this study (Previts et al, 1990a). At this stage, it is simply argued that undoubtedly Chambers was a ‘great person’ in accounting (Barton, 1982, p128; Mathews, 1982, p177-178; Edwards, 1994, pxv; Staibus, 2003, p167 & p179-181; Colasse, 2005). He was certainly aware of ‘economic and commercial matters’, writing on these, as will be evidenced as the study proceeds, so to lead to changes therein. Further, his writing would suggest he would have agreed with Watson’s wide ranging view of science – a view which recurs throughout this study. This view, along with that of Beard (1946, p7), sees advances in knowledge in particular areas. As the study progresses, data from the Collection will support these opinions.

A study which uses material from treasuries such as the Collection emerges from various motivations - personal, professional and academic. While concern here is primarily with those of an academic type - intellectual rigour in the pursuit of a solution to problems in accounting concerning the element liability - hopefully there will be, from the findings of the study, professional consequences as well.

Academically, Chambers continually stressed the need for intellectual rigour or ‘logic’ in the resolution of debates. He (1970, p13) wrote of two things,

- internal logic,

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7 Beard (1946, p7): ‘Great thinkers in the humanistic sciences employ abstractions drawn from knowledge of history-as-actuality and thus covering less than the totality of human life in its time-span. ... By making use of such constructs ... they advance their respective sciences.’
Both internal logic and external verity were key influences on his work. Chambers recalled in personal communication and in various seminars and writings (Gaffikin, 1986, p140-141; Wolnizer and Dean, 2000, p247) his earlier working days when he was dealing with price justification issues (external verity) and a problem of linking together various published data (internal logic). Other illustrations are identified and analysed elsewhere (Dean, 2000).

Using these influences, academically and professionally Chambers over time developed a system for reporting of financial information by corporations based on market (in particular) exit prices – called Continuously Contemporary Accounting or CoCoA. His seminal work, Accounting, Evaluation and Economic Behavior, was published in 1966 after years of observation (or external verity), thought and writings (or internal logic). He was to spend ensuing years defending and refining that system, in the light of further observations and criticisms of the system, while seeking CoCoA’s acceptance in the business world. This entailed many means, all recorded in his extensive Aide-Memoire (Chambers & Dean, 2000; web site of the Archives at http://chambers.econ.usyd.edu.au/).

Chambers (1966a, p6-8) described the method employed as one ‘of construction’. This entails a study of accounting within the environment in which that accounting is done. A similar method is employed in this thesis to resolve tensions found in the accounting for liabilities.

To be so accepted, at least two things were required. First a change was needed from the system found in the then present reporting which here is termed conventional accounting. Second, contiguously there were available other systems which were competing with CoCoA as the preferred change. The changes required and the competing systems (or models) can be analysed and compared at various levels of abstraction. This requires a framework to facilitate logical analysis.

1.3 Framework for analysis used in the study

The search for a workable CG remains topical. The breadth of matters is well shown in Moizer (2005a). There he (2005, pxi et seq) ranges over issues like related parties, financial statements as reporting options, the function of auditing, potential conflicts of interest in general and for auditors in particular and other dilemmas met in theory and in application.

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8 Chambers (1970, p13, emphasis added), ‘What do we mean by a “logical point of view”? Two things. When we are dealing with statements, descriptions, definitions and inferences we mean that we are concerned with the propriety with which statements may be joined together and the propriety of the inferences we draw from them. But when we are dealing with statements which represent real-world phenomena, we are concerned also with the propriety of our descriptions of real-world phenomena, and with the agreement of our conclusions with real-world phenomena. Mathematics and formal logic are examples of the first class of things logical; the physical and experimental sciences illustrate the second class. We are concerned with internal logic and external verity.’

9 This system has been given various names by researchers and commentators, including exit price accounting, selling price accounting, Current Cash Equivalent accounting and market price accounting. It of course could be applied to other forms of business entities but for purposes of this study, the emphasis is placed on reporting entities as defined in AARF (1990).
As regards this study, one key idea is that of management of reporting entities being required to report various matters to shareholders and other stakeholders. It is argued that conventional accounting data – a mix of primarily capitalisation of costs data augmented by selected market price data - for much of the twentieth century held sway in times of CG within a quasi-legal domain. This was despite various attempts to require a reporting of data of a financial type where ‘performance’ was required to be evaluated. However, it is argued here that in various debates, data of distinct types have been intermingled so that as well as the two types of data above, data of an economic type and of a social type are to be found.\(^{10}\) In these areas, performance indices were being reported which were not simply expressed in financial terms. This intermingling must be unravelled if problems regarding liabilities are not to be simply recycled.

These ideas were formulated from previous reading, discussions with colleagues (including with Chambers personally) and other research. It suggested a basic logical flaw (perhaps a ‘paradox’ according to Chambers, 1962) in arguments on the reporting by management to other stakeholders in a corporation.

The paradox concerned the incidence of economic and social phrases and terms in

- the CF project and its various levels of abstraction (AARF, 1987, 1988; Sutcliffe, 1984, 1985),
- various debates on financial guidelines, especially those for Government Business Enterprises (Australian Water Authorities, 1987, 1988), and

While this incidence made sense at some levels of abstraction, (for example, as it was argued earlier in this chapter, Chambers certainly used economic ideas underlying his CoCoA), it seemed, at the actual reporting level, to suggest the inference that both an economic and a social concept of position and of performance can properly be the output from financial systems. This seems at best perverse logic.

It is within this environment that the ‘method of construction’ is here applied to accounting for liabilities. What is required is an appreciation of the function of accounting in first CG and second decision-making, the latter being what Chambers terms ‘choice’. Next, the function of financial reporting at one level and financial statements at a narrower level needs to be established. As this thesis continues, it is argued that tensions are found in accounting for liabilities. Indeed, some tensions may be traced back to tensions in accounting in general.

Within this framework, recurring problems are found in the reporting of liabilities (notwithstanding the work done in the CF projects since the late 1960s). To structure

\(^{10}\) In this study, ‘social’ covers many areas of interest or specialization and is used in a most general sense. West (2003, p5) describes how many distinct ‘disciplines’ may be incorporated under the ‘social’ grouping used in this study, ‘The discourse pertaining to accounting rule-making is therefore significant and extends across legal, economic, cultural, institutional, political and historical frameworks. However, when attention has been directed to the rules themselves the worth of the whole process is brought into question.’
argument, a series of propositions/research hypotheses (summarized in Figure 1.1) are
developed in the study:

**Proposition 1:** Does the treatment of liabilities under conventional accounting meet
the needs of CG? (See especially Chapters 2 to 5).

**Proposition 2:** Does debate over a Balance Sheet or Statement of Financial Position
introduce grounds for recycling debates on liabilities? (See especially Chapters 3 to 6).

**Proposition 3:** Does the introduction of economic and social ideas and concepts into
financial CFs lead to grounds for recycling debates on the element ‘liability’? (See
especially Chapters 3 to 7).

**Proposition 4:** Do issues in the definition and recognition of the element ‘liability’
lead to grounds for recycling debates on that element? (See especially Chapters 7 and
8).

**Proposition 5:** Do the various meanings attributed to the term ‘value’ introduce
grounds for recycling debates on liabilities? (See especially Chapter 8).

**Proposition 6:** Do issues of measurement in general and of liabilities in particular
introduce grounds for recycling debates on liabilities? (See especially Chapter 8).

**Figure 1.1**

<table>
<thead>
<tr>
<th>Conventional Accounting</th>
<th>Primarily Legal</th>
<th>Compliance</th>
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<tbody>
<tr>
<td>P2</td>
<td>P4 &amp; P6</td>
<td>P1</td>
</tr>
<tr>
<td>Financial Reporting</td>
<td>Legal &amp; Financial</td>
<td>Position &amp; Performance</td>
</tr>
<tr>
<td>P3 &amp; P5</td>
<td>Legal, Financial &amp; Economic</td>
<td>Position &amp; Performance Indices</td>
</tr>
<tr>
<td>Economic Reporting</td>
<td>Legal, Financial &amp; Economic</td>
<td>Position &amp; Performance Indices</td>
</tr>
<tr>
<td>Social Reporting</td>
<td>Legal, Financial, Economic &amp; Social</td>
<td></td>
</tr>
</tbody>
</table>

In Figure 1.1, the first column lists the four distinct types of reporting used in this
study. Interactions among these form Propositions 2 to 6 inclusive. The second
column reveals how various disciplines are related to the particular types of reporting.
Conventional accounting, as is shown in Chapters 2 to 4, was primarily of a legal type
dealing with compliance under a narrow stewardship function (Proposition 1). That is
not to suggest that other influences on accounting were not in play (see Chapters 5 to
7). However, major debates followed from the intermingling of ideas from the various
disciplines. They would be resolved, if at all, only by a structure incorporating
particular levels of abstraction.
In summary, the context here is CG of the modern corporation. P1 is concerned with CG and conventional accounting; P2, P4 and P6 are concerned with conventional accounting and financial reporting (with perhaps indirect effects on economic and social reporting); P3 and P5 are concerned with all four levels of reporting;

1.4 Justification of the study
Justification can be discussed at various levels of abstraction. At a higher level, it is supported by a claim by Popper (1966, p136):

> It has been said, only too truly, that Plato was the inventor of both our secondary schools and our universities. I do not know a better argument for an optimistic view of mankind, no better proof of their indestructible love for truth and decency, of their originality and stubbornness and health, than the fact that this devastating system of education has not utterly ruined them. In spite of the treachery of so many of their leaders, there are quite a number, old as well as young, who are decent, and intelligent, and devoted to their task.

Undoubtedly, universities play a major role in most societies. A major debate in higher education over recent times concerns the nature of the university (or the academy). The debate usually takes the form of a ‘collegiate’ versus ‘managerial’ approach (Bergquist, 1992) to the policies and the running of the university, in which accounting plays a part. Leaving aside questions of age, decency and intelligence, this study can be justified by its seeking to assist those devoted to improving the role of education in general and of accounting in particular, as was Chambers (1948a, 1968a, 1987 and 1999).

At another level, support is provided by the recycling claim of Sterling (1979) met earlier in this chapter. If this study helps prevent other researchers from recycle issues from various debates, especially those found in the reporting of liabilities, the study will be justified. This justification is a timely reminder as shown by an unexpected coincidence in which, towards the end of the research for this thesis, Botosan et al (2005, p159-169) question issues of definition, recognition and measurement of liabilities which still remain:

- What distinguishes debt from equity?
- If an obligation is to be settled in shares, when should it be classified as debt?
- If an obligation is to be settled in debt or shares, how should it be classified?
- How are various components of the above to be measured?
- Does a guarantee with a low probability of occurrence need to be recognized as a liability?
- If so, how is that liability to be measured?
- As the probability of occurrence changes, does the measure of the liability change?
- When is a liability to be derecognized?11

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11 Botosan et al (2005, p159), 'What makes an obligation a liability? Accounting for obligations as liabilities is a complex area of accounting, with important and pervasive implications for how well
While the business world may face new types of liabilities like hybrid derivatives, certainly the above questions suggest a degree of recycling of issues, as will be revealed as this study progresses.

At a more personal level, justification is provided from this researcher's link to Chambers and his works. It began on arrival to Chambers' staff in 1966. In that year, students in Accounting III, Term II, studied Chambers (1966a) *magnum opus*—arguably its first use as a set text in formal study—and Edwards and Bell (1961). Over the years since then, Chambers' works and ideas have provided an ideal for teaching and research interests. Links were retained by formal teaching, supervision, discussions with Chambers personally and with other colleagues.

### 1.5 Objectives and plan of the study

In this study, the inclusion of 'liabilities' in accounting generally, and within the CoCoA system as developed by Chambers, is examined. In order to assess the impact of that system on the reporting of financial position and related performance, it is essential to gain an understanding of its historical development.

CoCoA as a system, as pointed out earlier in this chapter, was seen as novel to many accountants, both academic and practitioner. Gell-Mann (1994, p264-265), in discussing how creative or novel ideas are conceived, writes of the experiences shared with various people (here, a group of physicists, biologists, painters and poets) he met with in 1970. The accounts of those in the group agreed to a remarkable extent that there were three steps. The first dealt with the identification of a contradiction/problem found with the present established theory or the way things were done. The second saw the continuation of further thought which tended to be useless at that stage. The third happened, often by chance, leading to the 'creative idea'.

While all in the group were impressed by the agreed three steps, Gell-Mann would later find that these were not new ideas. Instead, this insight could be traced to the late nineteenth century when Hermann von Heloltz termed the steps *saturation*, *incubation* and *illumination*. Early in the twentieth century, Henri Poincare was to add a fourth—*verification*. These four steps are used in the plan of this study.

Chapter 1 provides the Introduction whilst Chapters 2 to 5 inclusive develop the framework for the analysis and discussion found in the study. In these chapters, the users of financial reports can assess a firm's current financial position, income, cash flows, and risk, and how well they can predict a firm's future income and cash flows. While accounting standard setters have long recognized its importance to financial reporting, accounting for liabilities still faces fundamental unresolved problems at conceptual, definitional, and practical levels, including when and how to recognize, classify, measure, and extinguish liabilities.

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12 Gell-Mann's views seem to be increasingly referents in the auditing literature. See Bell and Solomon (2002, p8).

13 Gaffikin (2003a, p305) comments, 'In logical positivism and its many variants and offshoots there was a distinction drawn between the context of discovery and context of justification... It was believed that discovery was too difficult to characterize so the philosophy of science should be concerned with justification.'
argument is structured around an idea implicitly suggested on the dust-cover of Littleton (1933). Pictured is the period of the 1400s belonging to Italy, the 1500s, 1600s and 1700s as an era of Italy-France-German developments, the 1800s the UK era and the 1900s a USA one. In this study, particular emphasis is placed on the Anglo-American link.  

This is not to argue that developments in other countries are to be ignored. Indeed, the material held in the Collection shows this did not apply to Chambers’ research. It is simply a requirement to make the study manageable. In Chapter 2, UK influences are examined, followed by a sub-section on concurrent developments in USA. In Chapters 3 to 5, the structure is reversed with USA seen as the dominant party. Littleton (1933, p361) explicitly concludes that his essay on the evolution of accounting is a story of interacting events - as is all history. This thesis therefore introduces a sub-section on what are termed ‘accounting interactions’. These in turn have implications for the reporting of liabilities – the thrust of this study. The analysis here will support or reject the propositions/research hypotheses. The framework established in Chapters 2 to 5 includes discussion of problems and controversies – in some ways a part of the saturation step.  

Chapter 6 certainly deals with the issues of saturation. Here, following the argument of Gell-Mann, particular issues concerning contradictions/problems in accounting and the reporting of liabilities are identified in a way consistent with the earlier chapters of the study. It covers the questioning of conventional accounting in the 1950-1960s, including Chambers’ contributions to debate on various issues and his proposed resolutions. Chapters 7 and 8 discuss the issues faced in debates on incubation – developments in CoCoA in general and liabilities in particular which tend to suggest the futility of the search for resolution of the identified paradoxes. Chapter 7 covers the steps in which selected debates arguably diverted discussion. The emphasis here will be on CF projects, emphasising the potentially misplaced focus of those projects where tensions arise from an intermingling of conventional accounting, financial, economic and social issues. As will be argued, various debates often seem to be at cross purposes. Chapter 8 will emphasise terminological issues as found in debates on definition and recognition of liabilities, as well as issues of their measurement.  

In the final section of Chapters 2 to 8 inclusive, the Argument is summarized and placed in a series of issues related to the Propositions developed in 1.3. The themes  

- identify selected general issues,  
- incorporate ideas of CG and choice,  

14 This approach does provide some limitations for the study as in Europe, it is argued by some that the Anglo-Saxon models of economic and social policies are not acceptable, mainly from cultural differences, and do not work there. See The Economist (2005c, p49); Kitney (2005, p10).  

15 This is shown by reference to letters and correspondence from the Collection. Chambers had dialogues with many scholars, as well as seeking local and international assistance and contributions, especially as he founded Abacus.  

16 Littleton (1933, p361) illustrates possible accounting interactions with changes in the phenomena to be included, with particular methods becoming less effective, with earlier items becoming irrelevant and with new methods and ideas emerging.
- incorporate those of accounting in general, and
- incorporate those of liabilities in particular.

The total Argument is reproduced in Appendix VI. In Chapter 9, conclusions made will provide issues of **illumination** – breakthroughs in debates in the 2000s which suggest potential resolution of various paradoxes.

As in most historical treatises, **verification** is provided by the verity of the observations selected and the internal consistency (or validity) of the total **argument**. It has been written that history may change like a chameleon in that it may reflect the answer required (Hayder, 2004, p361). Be that as it may, history has a place in education, though it may be minimized in some curricula and research. However history does not wait simply to be found but requires conscious effort for any conclusion reached.\(^{17}\)

**1.7 Limitations of the study**

Chambers (1979, p764) has commented on the risks met in reviewing historical work of some time ago. He could not phrase answers which to him were entirely satisfactory.\(^{18}\) This study suffers these risks as well.

Building on Gaffikin (2003a, p306) who argues for 'a continuum in respect of how theories are established from discovery to justification', secondary data (as opposed to secondary sources) are used as the sole basis for evidence in this study (Previts et al, 1990). The evidence relies mainly on writings of and archival material collected by Chambers over his lengthy career in academia (a primary source) as well as writings and historical research by others (a secondary source). The argument will use published data from academic, professional, semi-professional and popular sources in a retrospective way.

Chambers’ methodology and related research methods used in the development of CoCoA have been well documented, analysed and reported by Gaffikin (1986) in his doctoral thesis. Gaffikin (2000) provides a shorter version (with a selected update) of

\[\text{\(^{17}\) Gaffikin (2003a, p305), 'There is a tendency in many disciplines to remember those scholars who went before as contributing something to the advances in knowledge.... Few current textbooks or other books in accounting revisit past accounting contributors other than just a cursory acknowledgement of a past. Is it a discipline without an intellectual history; are the contributions of the past scholars to be totally denied?'}\]

\[\text{\(^{18}\) Chambers (1979, p764), 'One may be aware of the antecedent literature and to some extent of practice at that time. But there is the risk that linguistic habits may have changed, the risk that opinions of others on the work may cloud one's judgment, and the risk of interpreting the work in the light of events and debates subsequent to its publication. To be aware of these possibilities is at least of some help.'}\]

\[\text{\(^{19}\) Gaffikin (p306) continues, 'The a priori researchers, in seeking the foundations for a theory of accounting, were essentially concerned with issues at the discovery end of the continuum. That is, they were concerned with establishing theories on "truthful" assumptions of observed business behaviour. The empirical/positive research that replaced their efforts in the post 1970 period is concerned with the other end of this continuum - justification - hence the exaggerated emphasis on testing and quantitative methods; they had new tools in computers and large stock market databases and newly developed research skills learned from their courses in research methods. However ... both "types" of research share ontological and epistemological positions (realism and positivism).'}\]
The thrust of the argument. The complexity of various ideas and related interrelationships in CoCoA — in both its development and the related applications — provided much ground for debate. For instance, in the latter, Gaffikin argued that Chambers' work is difficult to classify or 'box' (p285) and he disliked being 'boxed' (p287). Indeed, the researcher recalls in personal discussion Chambers making the point of not to box people or their argument in debate as it was often 'a sterile thing to do'.

Despite such protestations, CoCoA was 'boxed' by some as normative and non-empirical, thus being discarded by some who claimed to be empirical. Resistance was also found to the use of scientific method — the ever-present debate whether accounting is art or science. Chambers showed the debate to be sterile, being an illustration of argument at cross-purposes. Does this provide limitations for studies like this one? Perhaps. While Cooper and Schindler (2001) set 'rules' applicable to technical methods of research, Sunder (2002, p159) points out, 'History is not simply everything that happened in the past; we select facts and organize them when we believe they might be useful in the future.' Thus research here faces the problem of selecting the 'goals and facts' as suggested by Randall and Haines (1946). An illustration is provided by Vallance (1955) whose book is extensively cited in the study.

20 Correspondence in the Collection (USA P202, Box 19, #7442) reveals Chambers' unease with some of Gaffikin's assessments.

21 At one level, the process of 'boxing' people and their work is an illustration of Thouless' (1953) dishonest trick (6) Diversion to another question, to a side issue, or by irrelevant objection (p171) or (35) Angering an opponent in order that he may argue badly (p175). As an analogy, (another dishonest trick though, remember, — number (33) Argument by imperfect analogy), it is the practice in 'sport' of physically attacking (playing?) the person rather than the 'ball' or the practice in debate — especially in politics — of verbally attacking the person rather than the argument.

22 Chambers (1964a, p6), drawing on the derivation of the term 'art' as something man-made, argues, 'The argument as to whether auditing is an art or a science is sterile. Engineering is an art; it is based on scientific foundations. Medicine is an art; it is based on scientific foundations. The real question about auditing is whether it is pure art, or whether it has some scientific, demonstrable foundations.'

23 Randall and Haines (1946, p22), 'In terms of these ends that have to be achieved, these goals forced on us by facts, men understand the present and the past, using these ends as principles for selecting what is basic in the histories they write.'

24 Vallance (1955, p1-2) writes of his research into fraud: 'The quarry from which this book has been dug is deplorably large. ... For this anatomy, since mine are not the laborious ambitions of an encyclopaedist, I have had to apply strict selectivity. The frauds with which the following chapters are concerned relate to modern times — to the type of society, in fact, which can be termed "capitalist". ... — I deal only with activities integral to financial markets and their traffic. Selecting still more narrowly, I omit — save for brief reference to a few notable cases — the skilled forgers of signatures on cheques and other financial documents ...." Finally, my concern is, almost entirely, with the history of frauds which were "public" — frauds, that is, not directed, like the confidence trickster's activities, at selected individuals, nor aimed at a single institution such as a bank or an insurance company, but organised for the unlawful exploitation of a significantly large section of the community.' One can find similar descriptions in case-based works like Chambers (1973); Clarke et al (1997, 2003); Kindleberger (1996).
Randall and Hines (1946, p17-18) apply this problem in a more general way in the context of a written-history (as found in this study). Some principle of selection is used to choose what is included. If a period elapses between two written histories, the principle of selection will probably differ appreciably. More facts may be found and circumstances change. The selection of social and economic events with accounting interactions is determined by the aim of the study. Others may see other events worthy of selection. For instance, Goldberg (1949, Part IV) selected the imposition in USA of excise tax in 1909, of income tax in 1913 and of an excess-profits tax in 1917 as of key importance in the development of accounting. Another instance is found in the switch from the dominant influence of UK events in Chapter 2 to the dominant influence of USA events in Chapters 3 to 5 inclusive, when the influence of stock exchanges is discussed. The London Stock Exchange (Special Sub-Committee, 1930) receives scant consideration, especially when compared to that given to the NYSE.

Indeed, the selection of what to include in this ‘history’ was, given the quantity of Chambers’ published writings, the even larger quantity of writings of others on CoCoA and related models and the wealth of material in the Collection, a problem. Certainly the ‘principle of selection’ in this study has certainly changed from ideas held when in 1966 Chambers’ CoCoA and the related treatment of liabilities were first examined.

As discussed earlier, arguments of this study are linked to CoCoA. However, much use is made in particular chapters of Chambers’ writings, both earlier than and later to 1966, the date of his magnum opus. They are related so as to fit within the overall argument as planned in Section 1.5. This is consistent with the idea of ‘a “multiple causation” theory’ (Randall and Haines, 1946, p19) as the principle of selection.

Finally, a limitation of the study is the liberty taken in the use of the abbreviations UK and USA. In various discussions, strict use may require ‘England’ or ‘Scotland’ rather than UK for instance while in others, like those to times before 1776, when there was no USA, strictly reference should be made to ‘colony’. The claim is made for some ‘poetic licence’ – an excuse first met and used in secondary school in Brisbane several decades ago.

25 Diamond (2005, p8), ‘We shouldn’t be so naïve as to think that study of the past will yield simple solutions, directly transferable to our societies today.’

26 Chambers himself (1975, p97) writes, ‘There are pitfalls in lifting ideas and arguments from their original contexts.’
Chapter 2 The Framework: Corporate Governance before the Twentieth Century - the Dominant UK Influence

The great change in the English law ... was brought about by a series of Company Acts (culminating in the Act of 1862), which made it easy to form Joint Stock Companies with Limited Liability.

Hicks, 1942, p90.

Each era is seen largely as the story of the economically dominant nation of the time.... from the seventeenth through the nineteenth centuries it is usually England.

Chatfield, 1977, piii-iv.

2.1 Introduction

In Chapter 1, research hypothesis/proposition P1 guiding this thesis concerned the inability of conventional accounting reports to act as an effective monitor/control in CG, except by chance. A corollary argument is that contemporary financial (in its pure sense) reporting would meet that need. It is argued here that Chambers was certainly guided by similar propositions while developing CoCoA.

One difficulty, as already pointed out in Chapter 1, is the vast scope of Chambers’ writings underlying his development of CoCoA and its influence on accounting theory and practice. As met in Chapter 1, one of Thouless’ (p170-176) thirty-eight dishonest tricks commonly used in argument provided (and continues to provide) scope for diversion to other problems. To overcome such problems, a context is required - one of CG.

However, even within a context there remains much scope for diversion in argument. In this chapter, it is argued that over time, social and economic developments interacted with financial and conventional accounting requirements. In dealing with these interactions, various tensions arose. As shown in Figure 2.1, two of these are termed institutional and information type tensions. Institutional ones concern the creating of necessary infrastructure to resolve selected issues of say due process and those dealing with professional matters. These are quite distinct from information tensions of which Chambers was most concerned. Indeed, he saw his CoCoA as a solution to information tensions, within his ‘total scene’.

27 Thouless (1953, p171), ‘(6) Diversion to another question, to a side issue, or by irrelevant objection (pp. 39-42). Dealt with by refusing to be diverted from the original question, but stating again the real question at issue.’

28 Vallance (1955, p8) argued that while the disclosure of frauds became inevitable when there was a downturn in the market cycle, the frauds were inspired by a preceding speculative upswing. He did concede that the generalization might need to be qualified, but concluded that financial fraud and peaks of the trade-cycle were closely correlated.
Interactions are well accepted in various studies. Certainly, record books and the related accounting have provided insight into daily life in ancient societies (Chatfield, 1977, p3). Indeed, the idea of reporting – of a position and/or of performance – has a long history.²⁹

**Figure 2.1**

In this chapter, it is argued that Chambers, being aware of a breadth of matters, considered various influences. One was the influence of ideas from UK, especially the Anglo-American type legal system and its common law approach. This system attempts to provide stability in social and economic conditions over time, while

allowing for contemporary changes therein to be reflected in the system. In this chapter, it is argued that UK was the dominant Anglo-American nation in the period before the Twentieth Century. Legal and economic issues were to interact with accounting. Arguably the balance was with the former, though economic ones were growing in importance.

A second was the influence of ideas from the USA, especially the role of market forces, the growing dominance of which was intertwined with the alleged inadequacies of accounting in

(i) unexpected corporate collapses, whether of a fraudulent or negligent type, and
(ii) information provided during merger/takeover disputes.

The argument in this chapter is built around attempts to control limited companies, in particular within the Anglo-American-Australian socioeconomic environment and iterations with the function of an accounting. It is concluded that precedents within UK experiences had legitimately influenced the reporting of liabilities.

The analysis in this chapter is of developments in UK until the end of the 19th Century. First, a brief background to CG is provided, especially as it is seen as critical to Chambers' argument (2.2). Here, reporting of financial data is a monitor or control device as well as a requisite for informed decision-making by particular stakeholders. Next, conditions before the eighteenth century are discussed (2.3). This is followed by the period of the 1720 South Sea Bubble (2.4), the period a century later to the 1844 Gladstone Committee and its contributions (2.5) and the period of the excesses of the late 1800s (2.6). Finally, a conclusion is provided (2.7).

2.2 A brief history of reporting in corporate governance
CG is part of a broader one – governance. As Chatfield (1977, p3) argued, obvious connections exist between ideas/concepts and the conditions within which people live. Indeed, he concluded that in general, bookkeeping methods and related accounting/reporting become more elaborate as the level of civilization rises. A particular level of civilization would be related to a state of governance found – the way people, things and various relationships are controlled. Here, the particular interest is the way in which companies and various interrelationships are controlled.

Many English words may be traced back to Greek or Latin. The term 'governance' is no different, as it may be traced to a Greek term used in a context of navigation. The Latin derivative of governance is 'gubernator', a term related to Greek helmsmen or 'kubernetes' who steered or directed their ancient sea vessels. Today one finds cybernetics – a study of control as a discipline in its own right. The term has application in a context of 'governors' in public companies and institutions like universities (Tricker, 1984, p243 & 248).

In Australia, some would quickly link the term 'governor' to a political meaning (governor-general). It is also found in social (of a school) settings, engineering (in machines like air-conditioners), legal (of a prison) and management (as a monitor) senses.
In this analysis, focus is on companies listed on a stock exchange\textsuperscript{31} and their inherent 'governors'. These concern the relationships among the various stakeholders in companies who are most interested in the strategic direction, position and performance of those companies. However, the governance of joint stock companies was to build tensions among various stakeholders.\textsuperscript{32}

An early debate in control by government was of the role of 'publicity'. 'Financial reporting' as part of accountability was discussed during times of company promotions, related speculation and following corporate failure (especially when unexpected) - none of which is new.\textsuperscript{33} In the 1800s, the early days of joint stock companies, UK influences in the Anglo-American group were paramount.\textsuperscript{34}

Here it is argued that financial reporting in general and financial statements in particular are, ultimately, 'governors' of companies. The internal and external audit processes, audit committees and Boards of Directors are others. In the development of and later argument on his CoCoA, Chambers used an instrumentation analogy. In specifying the domain of accounting, Chambers (1991b, p21) asked readers to consider

(a) Can the navigator of a ship or an aircraft proceed safely without more or less exact knowledge of position from time to time?
(b) Can other ships or aircraft in the same region proceed safely without knowledge of the positions of one another at the same time?
(c) Can the position of a ship or an aircraft safely be supposed to be determinable by idiosyncratic calculations of its navigator or his aides?
(d) Is the analogy of navigation an appropriate analogy for the conduct of the financial affairs of firms?

His answers (1991b, p183) read respectively No, No, No and

The analogy is fruitful. There are goals or ends to be attained, in a continually changing environment, where impediments or hazards may arise unexpectedly, and where the avoidance of mishap depends on the exercise of foresight and judgment within the bounds of what is considered safe or serviceable functioning.

The ideas set the scene involving a range of stakeholders. At one extreme, management would seek selected data to be reported towards attaining goals/ends

\textsuperscript{31}To some, functions of these exchanges include the establishment of a market in which investors may practice informed trading in shares and stocks. Ney (1970, p4) questioned whether this was so given the manipulation (potential and actual) by members (especially specialists in USA) of those exchanges.

\textsuperscript{32}For instance, at the beginning of the twentieth century, Jackson (1984, p218) writes of the USA President Theodore Roosevelt, "When I became President," he recalled in his autobiography, "the question as to the method by which the U. S. Government was to control the corporations was not yet important. The absolutely vital question was whether the Government had power to control them at all." Developments in USA are further discussed in later sections.

\textsuperscript{33}Valiance, (1955, pI) points out that schemes to deceive have persisted from early biblical times.

\textsuperscript{34}For example, many laws and customs in USA had their origin in developments in UK (Hein, 1978, pI). In Australia, various laws were in general faithful copies of those in UK, as might be expected given colonial ties (Evans, 1974, p63).
while avoiding hazards. At the other extreme, stakeholders external to an entity would require selected data reported on whether particular goals/ends were attained in order to incorporate the result in their decision-making.

Chambers (1991b, p123-129) also discussed the instrumentation required. Included is a diagram headed ‘Financial Instrumentation’ (Chambers et al, 1987, p17). It appears within ‘The Context of Financial Calculation’ (p5-23) and like most of Chambers’ writings, includes many interrelated matters. This argument supports Chambers’ view of CoCoA as a ‘financial instrumentation system’ (p13) to be used within a CG system. The argument now moves to the early days of companies in UK.

2.3 Before the eighteenth century
It must be stressed here (recall 1.5) that emphasis is on Anglo-American developments. Consequentially, those in other countries (especially European) are only briefly referenced. This is not to deny their possible impact but this is left for other researchers.

In the fifth century, Augustine observed that those in power in the fragmented territories of the Roman empire were often unaware of the link between their application of power and an (often implicit) underlying philosophy. Augustine argued that institutions derived permanence, continuity and significance from the underlying philosophy rather than from the use of power (Berle, 1954). Here, two distinct but linked ideas are found,

- application in practice, and
- underlying reasoning or philosophy.

Debates involving these recur continuously in this study.

Augustine was to help set a Christian-based philosophy which gave impetus and direction to institutions, including corporations, well into the Middle Ages (Berle, 1954, 180-181). Indeed, Judeo-Christian values and ideas were to play key roles in legal and economic developments to the present time (Littleton, 1933, p242-244). From various anecdotes like that of the talents, ideas emerge. In one, a narrow

35 These have been succinctly summarised by West (2003, p2), ‘When functioning as properly calibrated instruments, financial statements describe in money terms the position of an entity relative to its external environment and how that relationship has changed over a specified period of time.’

36 A related statutory link was the influence of the UK taxation system with its focus of income as a net flow concept based on trust laws concerning the differentiation between corpus and remainder. This differentiation between revenue and capital gains impacted on the development of accounting principles, an effect some in the profession find difficult to abandon even today.


38 Littleton (1933, p16) suggests a lack of appreciation of this link influenced the decline of that empire and led to the Dark Ages which followed.

39 In this parable (The Holy Bible, Matthew, 25, 14-30) a master has three servants. To one, five talents are given, to another two and to the third, one. After a set period, the servants are called to account. The first and second, we are told, use their talents and return the five talents plus another five and two
accounting (as provided by the third servant) is suggested - the return simply of the original stake. Here, the report would simply state the 'position' of one talent, perhaps where it was stored and its eventual return. In another, a broader accounting is sought. The steward is accountable for both the original 'stake' and use made of the original 'stake'. Thus the accounting includes

- the original position statement,
- another at the end of a given period of time and from these two statements,
- a change in position statement over that period is deduced, a performance statement.

Depending on whether an accrual or a cash approach is taken in the development of the position statement, the performance statement will be of a profit/loss or of a cash surplus/deficit type.

In UK by the 13th Century, the relationships among nobility-steward-auditor were well established in accounting for the manor (Littleton, 1933, p262; Most, 1969; Chatfield, 1977, p24-29). The manor being self-sufficient, a narrow stewardship or agency relationship sufficed. Accounts were kept by various officers as protective devices to support their report and potential audit thereof. Even this narrow stewardship relationship required set skills (Chambers, 1973, p21; 1999, p126-127). Indeed, a farming boom created a dearth of clerks and auditors for manors, leading to set courses being part of the curriculum at Oxford (Chatfield, 1977, p28). These skills would be broadened and refined by later developments such as joint-stock companies and limited liability (Littleton, 1933, p288).

The end of the Crusades (1096-1291) introduced new products and trade contacts. These in turn led to a 300-year commercial/financial revolution in Europe (Littleton, 1933, p17-18, p158, p362). It would be seen by some to foreshadow the Industrial Revolution of the 18th Century (Chatfield, 1977, p33). Commercial ventures developed into affairs with multiple ownership and trading transactions carried out often by agents. Investors' need of a determination of the venture's results in turn required an accurate recording (Goldberg, 1949, Part II), one emphasising both position and performance.

At least as early as the 15th Century a device was followed in UK whereby promoters distributed stock in an enterprise run by a Board of Managers. This foreshadowed a process of social and economic change which would continue well into the 20th Century – the joint stock corporation (Littleton, 1933, px-xi, p205; Berle, 1954, p30; Lee, 1976, p23; Chambers, 1999, p129; Flesher et al., 2005, p24). Historically, incorporation required the necessary sanction of the state, usually by Royal charter or by special Act of Parliament.40

40 Some formed from 1485 to 1700 were of the former and more often than not included an element of monopoly, especially in cases where the venture required a large initial investment. They included the Russia Company (1555) with a monopoly in lumber, the East India Company (1600) in spices and the Hudson's Bay Company (1670) in furs. After 1688, such charters required the sanction of the Legislature. As well, charters or equivalent letters patent were granted for a special statutory authority
Parliament at first found the joint stock company an easy way to regulate and tax activities. These were very similar to partnerships as usually unlimited liability was imposed, though transferable shares were possible. In some cases, limitation was placed on the liability of shareholders (Chatfield, 1977, p79), a practice found in various countries (Littleton, 1933, p247-248).41

During the 17th Century, the centre of economic (and arguably social) life moved from manors to towns (Littleton, 1933, p207). Commercial advantages flowing from and incident to incorporation were becoming clear. These included

- continuity,
- management independent of other members,
- ease of legal actions against third parties or against members,
- transferable shares, and
- distinct liability for the debts of a corporation (Hunt, 1936, p3).

Competition among manufacturers arose and overseas trade extended (Chatfield, 1977, p33).

Accounting reports therefore had to deal with various issues. The continuing nature of the corporation required data dealing with issues like

- permanent capital,
- a distinction between capital and income if the monies invested in the entity were to be maintained, and
- the income available for dividend distributions (Littleton, 1933, p206).

These issues were discussed also in a context of a transformation of ventures from being speculative to investment-for-steady-returns.42

While by 1700 the advantages of the joint stock company (as a valuable tool especially in the promotion of new industries and for the mobilization of investment funds) had been recognized, it had also become clear that it might be used to defraud investors and encourage wild speculation43 or gambling in shares (Hunt, 1936, p6; Hein, 1978, p115-116). The need for some protection would emerge.

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41 Hein (1978, p96-97) completes the saga thus, 'The great chartered companies were gradually forced to give up their monopolies. The last to do so was the Hudson’s Bay Company in 1868 ... Since 1688, the right to grant monopolistic power has been reserved to Parliament ... and in more modern times this right (other than patents to inventors) has been granted only to “natural monopolies,” normally the so-called public utilities.'

42 Littleton (1933, p201-213) uses the experiences of the East India Company as evidence, including an aside on 'permanent capital'.

43 Gower (1957, p36); also Ney (1970, p245-8) refers to UK-European attempts to legislate against speculation for some 300 years. Similar tensions were to continue to present times.
Further development of mercantilism drew on both economic and social matters. Goals included an increase in the national wealth and the establishment of a strong business community. The corporation was to become a preferred type of business form and related profits were seen as a source of both personal and public good. However, as these required monopoly powers both in theory and in application (Chatfield, 1977, p78; Hein, 1978, p94-95), issues of control were raised including to which parties those corporations were accountable.

UK was a key player in international struggles for economic power based on overseas commerce and, above all, colonies. National wealth and well-being were dependent on monopolies in trade and treasure from distant lands. For social honours, money begun to vie with land, as wealth was to originate from trading activities (Littleton, 1933, p155). Arguably the creation of an acquisitive society was at hand. However, below the scene lay real economic problems. Wars costly to UK and France saw both Exchequers in financial difficulty. Although the Bank of England had been established, the issue of notes was strictly circumscribed by the amount of bullion owned by or deposited with the bank. Credit had not yet been developed effectively as part of the economic system (Valiance, 1955, p11-12; Gleeson, 1999).

The year 1690 was the beginning of some thirty years of financial speculations. In Parliament, alarm was raised on the effects on national trade. A report from an Investigatory Commission in 1697 indicated a dual goal – protection of investors from fraud and the encouragement of investment in new, legitimate business (Hawkins, 1962, p3-4). This would take the argument into the next century and, ultimately, the rise and collapse of the shares in South Sea and other ‘bubble’ companies.

2.3.1 The USA scene

Baxter (1956, p272-273) paints a scene in colonial USA where barter was common as UK forbade its colonies a local coinage. Various types of paper notes were exchanged based for example on tobacco in Virginia or land and silver in Massachusetts. While UK and other European links and ideas circulated, trading entities had neither tax requirements nor other reasons to calculate a profit figure (Baxter, 1956, p279-280; Parker, 1982a, p139).

Sobel (1965, p1-13) in his history of the New York Stock Exchange (NYSE) also discusses the background USA inherited from UK and Europe. The various waves of speculation, from the tulip market craze, panic and collapse in the Netherlands in the early 17th Century, through the French experience surrounding John Law’s Louisiana Company to the South Sea Company and their early 18th Century contemporaries.

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44 This was termed ‘goldsmith banking’ (Valiance, 1955, p14). The history of the concept in UK is traced and discussed by Shelton (1956, p247-254).

45 However, Flesher et al (2005, p22) lament that various writers presume that in USA, little happened (especially regarding auditing) prior to UK accountants/auditors arriving during the post-Civil War manufacturing revolution. They question that presumption and trace the use of accounting (and related auditing) from the early 1600s of the Pilgrims and the Puritans.

46 The ‘Mississippi Bubble’ burst in 1720, affecting the Louisiana Company of John Law who is met again in 2.4 (Gleeson, 1999, p149-162).
European investors in general and UK investors in particular invested world-wide, including USA.

2.3.2 Accounting interactions
During this period within the then social and economic frameworks, accounting was initially used as a control device. However, a major interaction was Pacioli’s write up of double-entry bookkeeping. Crosby (1997, p199-223) rates this as one of the reasons for developments in the Renaissance period, the rise in status of Western civilisation and its dominance in trade (both national and international) in later times. The importance of double-entry was that it transformed bookkeeping into a technology (Littleton, 1933, p156-157) which would later see institutional tensions created of a professional type. Of course, as with most histories, not everyone shared this view and debate continues (Yamey, 2005; Dean et al, 2005).

At the same time, information tensions overlapped as the ‘balance account’ (which had been seen as a bookkeeping control) evolved into a ‘balance sheet’ (Chatfield, 1977, p68-69). This occurred in Europe (especially Italy, Germany and France) in response to the levy of property taxes, potential bankruptcy proceedings and issues related to partnerships. As regards this study, a major impetus was provided by the appearance of the joint stock company. Both creditors and shareholders were to demand information in the form of a report of the capital invested and profit determined (Hunt, 1936; Goldberg, 1949, Part II; Chambers, 1973).

Until this stage, periodic calculations of a firm’s profit were of little interest to owners closely concerned with the firm’s operations (Yamey, 1979, p231). Distinction between capital and income introduced into accounting thought the economic notion of ‘capital’ assets. Consequences followed for the calculation of income (Littleton, 1933, p213). Accounting problems arose as particular statutes would not define ‘income’. A series of legal court decisions were required to resolve these problems, leading to a series of conventions which would influence information tensions met in later sections of this study.

2.3.3 Reporting of liabilities
As regards issues of definition, reference may be made to the developments in ‘legal liability’, including the law of promises, debts, notes, for taxation and pledge type borrowing (Plucknett, 1956, p17-18, p30, p58, p96 & p97 respectively). Similar ideas are found in Crivelli’s (1924) translation of Pacioli’s treatise. Although the term

47 For instance, the principal control placed on the sheriff was an annual accounting at the Exchequer (Goldberg, 1949, Part I; Plucknett, 1956, p102).

48 Littleton (1933, p63-76) refers to extracts from the Geijsbeek (1914) translation. Elsewhere in this study the Crivelli (1924) translation is cited.

49 Yamey (1979, p233-234) writes, ‘The calculation of periodic profits was subordinated to the need to have complete information in the ledger, even where this involved an obvious over-statement of profits and of the ‘value’ of the asset in question....The profit-and-loss account in early accounting seems to have been the rag-bag into which unwanted account balances were cleared, either at regular intervals or irregularly at the whim of the accountant, or when particular accounts or the ledger itself was full. The clearing process relieved the ledger of many accounts, the contents or balances of which were no longer of administrative interest to the accountant or owner. This left the accounts of assets and liabilities in the ledger, since these were necessary for administration and control.’
‘liability’ is not used in the translation, inferences as to definition by illustration or example are possible from several passages.

It is stated (Crivelli, Chapter 1) that to be successful in business, one must have access to cash directly or indirectly through credit. The use of another’s money or goods to establish a business is recognised, but the term ‘liability’ is not used to describe relationships.

The treatise states the rules required to record certain aspects of specified interpersonal relationships. Relationships of concern to liabilities include

(a) persons to whom the term ‘creditor’ is applied;
(b) certain persons from whom goods are purchased on terms or time payment;
(c) with certain public offices;
(d) ‘friends’ who lend cash;
(e) ‘friends’ who lend specific goods;
(f) ‘friends’ to whom a promise is made, an obligation is owed or a security is offered;
(g) persons with whom conditional dealings are made;
(h) persons from whom goods are purchased ‘on time’;
(i) ‘travellers’ to whom goods are advanced, and
(j) persons to whom an obligation is owed.

These illustrations describe instances in which a liability would exist. Relationships like these would be used in common law courts.50

While the idea of credit in commerce and the rules for recording were well established (Littleton, 1933, p13-14), there were only limited uses of the idea in reporting. Loans, a particular liability, were usually pledged against particular assets (Crivelli, p19), bills of exchange among trading firms and bank exchange dealings were used in trade and personally (p19-20, p29-32, p155). A distinction was found between legal and moral obligations (p32).51

2.4 The South Sea Company, the ‘Bubble’ and its aftermath
Arguably the most notorious of chartered companies was the South Sea Company. Its collapse and related large financial losses to various stakeholders led to the Bubble Act of 1720, thus making unincorporated joint-stock companies basically illegal (Gower, 1957, p29-30; Carswell, 1960, p269-270; Wanless, 1971, p12-15; Hein, 1978, p100).

A name of import here is that of John Law (Gleeson, 1999) – briefly mentioned in 2.3.1. He was a talented mathematician with some knowledge of ‘goldsmith banking’. In line with the social mores of the times, he also had a taste for gambling and

50 Arguably, the foundation of modern commercial law was these courts’ claim to hear mercantile cases and the adoption of the policy of deciding these cases in the light of mercantile custom – again an area of conventions - instead of by strict rules of common law. These cases included those of employers’ liability for the acts of servants done in the course of their employment (Plucknett, 1956, p246-247).

51 One currently debated is the James Hardie asbestos case where tension is found between the company’s legal liabilities and the claims for moral or equitable obligations facing the company (Haigh, 2006, p5 and 226-227).
dueling. An incident of the latter required him to flee to the Continent where he studied various banking practices. He developed economic and monetary theories far in advance of his time, reasoning that since trade and industry depended on money and since 'goldsmith banking' was constrained by the scarcity of gold\footnote{Some argued that silver too might be included.}, commerce lacked the stimulus required by an economy. Instead, he reasoned that the State might issue paper currency based either on land or the credit of that State, thus making the convertible-into-gold standard obsolete (Carswell, 1960, p160; Sobel, 1965, p8-9; Vallance, 1974, p14-15; Gleeson, 1999, p170-171).

In 1719, Law put his reasoning into practice in France. In UK, John Blount, a director of the South Sea Company, admired Laws' operations. Blount applied Law's scheme to takeover the National Debt (Watzlaff, 1971, p11-12). The idea was in no way criminal. It seemed of benefit to the Company, not the directors individually. While some opposed in Parliament the Bill to authorize the contract, later investigations would show that Blount used questionable methods to ensure the Act was enacted (Sobel, 1965, p9-10; Haldane, 1970, p26-27; Vallance, 1974, p19-21).

The market in South Sea shares was based on rumour and high dividends. Blount, now knighted 'for services rendered', and others made fortunes from selling their shares.\footnote{Haldane (1970, p23) notes, 'While there was no formal Stock Exchange, business was conducted in coffee houses of which in the early eighteenth century there were more than a hundred in London. One of them in 1773 became the site of the first Stock Exchange – the uniformed employees of which are still called waiters – and another of Lloyds, the underwriters.' See also Sobel (1965, p11-12).} The South Sea boom saw companies floated, often without legal status. Some were respectable, others not so (Sobel, 1965, p10). When the share price began to fall, the directors sought to support that price (Vallance, 1974, p23-24) – a practice still found presently in various collapses.\footnote{See the HIH case in Clarke \textit{et al}, (2003, p222-245).}

A Secret Committee of Inquiry into the South Sea Act was appointed by Parliament. It found that some books of account were missing. Those examined included fictitious or questionable entries (Haldane, 1970, p30; Vallance, 1974, p24). In the preamble to the Bubble Act (6 Geo I, c18), it was argued that unwary persons had been induced to invest under false pretenses, not only in the data presented but also in the legal status of the so-called corporations (Hunt, 1936, p7).

The joint-stock system was seen by some as the 'sole and sufficient explanation' of the economic and social troubles of UK (Hunt, 1936, p8-9). For some 100 years, the formation of new joint stock companies was restricted, incorporation remaining particular rather than general (Littleton, 1933, p288). This would retard the use of the most suitable form of enterprise required in the Industrial Revolution (Hunt, 1936, p9; Chatfield, 1977, p70 & p81) in both UK and its colonies (Flesher \textit{et al}, 2005, p26).

During 18\textsuperscript{th} Century, it was demonstrated that the corporate organization had distinct advantages in raising the large amounts of capital needed in selected projects. This was shown by some corporate survivors of the South Sea period and by the success of
the canal companies. Shares in the latter became standard investments (Hunt, 1936, p9-10).

However, little followed regarding accounting provisions to safeguard the interests of shareholders or the public in general. Instead, prevention from further abuses was sought via stringent conditions in company formation (Hawkins, 1962, p1). The passage of the Act in 1720 adversely affected the general level of confidence. Some argue that it exercised ‘a deterrent psychological effect’ on company promotion (Hunt, 1936, p9). This is contestable as, instead, joint stock partnerships were used, especially in the insurance industry, when charters were refused. These included the Equitable Society (1761) and the Phoenix Fire (1782) (Hunt, 1936, p11-12).

Corporate collapses included the South Sea Company and various contemporaries. A century later, a boom occurred when the Napoleonic wars and growth in canals and railways saw a growth in company promotions.

People and capital became associated in new fields of investment, as evidenced by an expanding Stock Exchange (Hunt, 1936, p14). While discussion of legal issues, such as ability to sue or be sued, unlimited liability and how to prevent frauds, occurred, related economic events were to influence developments in both UK and USA. Debate was had on various matters –

- whether a company and monopoly were synonymous,
- limited liability, and
- a preference for and superiority of individual enterprise over the use of companies for industrialisation (Hunt, 1936, p17, p19, p26, p55, p57).

Cycles of booms and slumps followed (Littleton, 1933, p271). The prosperity of the Napoleonic years waned and deflation followed. The end of war expenditure led in turn to fewer taxes, so abundant capital was available. 1824-25 saw a boom comparable to that preceding the South Sea Bubble. The stage was set for a wave of business expansion and related speculation, especially in foreign (South American) loans which offered UK investors higher interest rates. Later, foreign mining ventures would attract UK investors (Hunt, 1936, p30-31).

The field for speculation was extended to local ventures. Shares were bought on instalment in companies which lacked a charter from Parliament. This in turn led to claims in Parliament of systematic fraud (Hunt, 1936, p32-35). Pervasive as well was the practice of the use of influential names as ornaments in a prospectus was found. However, it was appreciated that it was not the role of Parliament to distinguish good from bad ventures – that was left to the investor (Hunt, 1936, p36-37).

Repeal of Bubble Act in 1825 followed doubts on the legal status of provisions of that Act, with the unincorporated joint-stock company being treated under common law (Littleton, 1933, pp251-252; Hein, 1978, p116-117). Pressure for its repeal had been

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55 Haldane (1970, p29); de Bedts, (1964, p3) writes, ‘The “Bubble Act” of 1720, passed by a parliament exceedingly aware of the contemporary wave of suicides, ruination, and imprisonment of high officials, caused a setback in corporate development overcome only by the industrial growth of the following century.’
compounded by increasing industrialisation (Hawkins, 1962, p1-2). It was argued that in dealing with fraudulent promotions, the common law was sufficient. As well, shareholders' liability was unlimited without a charter from Parliament, which was still jealously guarded (Hunt, 1936, p40-41). The repeal was followed by a disastrous economic slump (Littleton, 1933, p272).\textsuperscript{56} A general inquiry by the House of Commons into the companies formed during the period found

- the use of dubious methods to obtain corporation,
- various kinds of financial sleight-of-hand, and
- speculation by promoters and directors (Hunt, 1936, p49, p56).

Debate continued on joint-stock companies, especially regarding limited liability. This concept was found in clauses of contracts which the courts were willing to enforce (Littleton, 1933, p252-253; Hein, 1978, p123). While Parliament continued to resist change to the concept within a general statute, others argued that underlying economic developments revealed a need for some legal framework to be erected, sufficient not only to protect the investor but also to facilitate the use of the business corporation to attract and employ capital (Hunt, 1936, p51; Hawkins, 1962, p6). However, legislation (like the Act of 1826 and that of 1844) continued to limit the corporate privilege of limited liability by registration under statute until the Act of 1855 (Hein, 1978, p126-127).

Speculation re-emerged in 1834 with a boom in joint stock companies in selected industries including banking, rail transportation, life assurance, mining and steam navigation.\textsuperscript{57} Again, members of Parliament warned against speculation in joint-stock companies (Hunt, 1936, p60-61).\textsuperscript{58} Debate followed as to the potential for ‘publicity’ to expose corruption.

An interesting exchange occurred between one William Clay and his adversary named McCulloch. The former argued for the limitation of liability of banks with two provisions: firstly that the capital was fully paid up and secondly, the banks’ affairs were given publicity by the periodical publication of their accounts. Clay’s proposals were ‘limited liability; paid-up capital; perfect publicity’. McCulloch argued the first proviso fallacious and was most contemptuous of the idea of control via ‘perfect publicity’.\textsuperscript{59} McCulloch would remain a staunch opponent of limited liability, arguing

\textsuperscript{56} In Australia 1826-1828, a financial crisis faced the first established bank there - the Bank of New South Wales (Sykes, 1988, p1-23).

\textsuperscript{57} Green and Moss (1982, p10) comment, ‘Since the 1830s purchase of shares in passenger shipping companies had provided investors with an important British-based alternative to railway shares and government stock. More importantly, because of the high price of new vessels, shipping companies and shipowners had, since the late eighteenth century, resorted to finance houses and investment companies for short-term funds.’

\textsuperscript{58} Australia also faced its first speculative boom in the 1830s. A buoyant whaling industry and a pastoral boom, especially in wool, saw a flood of UK funds into commercial interests (Sykes, 1988, p24).

\textsuperscript{59} McCulloch (quoted in Hunt, 1936, p70), ‘It astonishes us that anyone living in London and having intercourse with practical men, should have been found to lay the least stress on the publication of balance sheets, or accounts of assets and obligations. They are worse than worthless, being eminently calculated to deceive and mislead. [To effect the plan leaves] it to the honour of the parties; that is by
the principle of unlimited responsibility was the basis for a solid banking system. He contrasted this with what he saw as the discredited position of the USA banks which had state charters and limited responsibility (Hunt, 1936, p68-71).

The promotion of joint-stock banks saw the introduction of a new technique in finance – shares of a small denomination (Hunt, 1936, p72). This would see the share market grow, providing a link between the large scale investment in industries like railways and the ability of the capital market to raise the required finance. The railway boom of 1835-1837 coincided with a boom in banks.

In 1837, a monetary panic led to the failure of several Anglo-American banks (Sobel, 1965, p44-45), with economic repercussions being felt in UK, USA and Australia.\(^{60}\) The setback continued for some seven years (Littleton, 1933, p272-273; Hunt, 1936, p101-102). Railways proved the exception, their shares displacing canal securities as standard investments (Hunt, 1936, p74-75).

During this period, the publication of any information, financial or otherwise, was jealously guarded by management. Indeed, shareholders were seen as being spies for competitors. However, within this general atmosphere, it was argued that a duty of some financial reporting was concomitant with the right to form joint stock companies (Hein, 1978, p241; p245).

Following a spate of insurance and other company failures (Gower, 1957, p40), in 1841 the UK Board of Trade requested the formation of a Parliamentary Committee to consider various issues related to the regulation of joint stock companies. In 1843, this became the Gladstone Committee.

### 2.4.1 The USA scene \(^{61}\)

The economy of colonial USA remained relatively backward. Much enterprise was financed by private UK investors, some in ventures similar to chartered companies. The USA economic and social climate in this period was overwhelmingly agrarian. Previts \& Merino (1998, p11-31) provide a summary of the times. Arguably, UK attempts to stifle business were causes for revolution.

The Revolution of 1776 saw the former colonies freed from UK statutes on corporations. Corporate power was granted quite liberally, various states permitting incorporation in many areas. The UK approach of selected use of incorporation to a limited few was in USA extended as part of a democratic and public good available allowing each bank to report as to its own credit and solvency! It is difficult to suppose that Mr. Clay can be serious … [as] even though the parties were perfectly honest, the publication of a balance sheet would be good for nothing.'

\(^{60}\) 1841 saw the collapse of The Australian Auction Company, which had promised much to investors. Mismanagement was blamed, with various management and directors being cited. One letter pointed out the apparent paradox of the collapse occurring when recently the auditors had inspected the accounts and had no criticisms of the position and performance of the company. Decreases in commodities prices and a credit squeeze from UK merchants contributed in 1840-1843 to the first major recession in Australia. On requirements for reporting by management of companies to interested parties, little eventuated (Sykes, 1988, p24-40).

\(^{61}\) Argument here draws heavily on works of Littleton (1933), Sobel (1965) and Jackson (1984).
equally to all (Littleton, 1933, p254-255). The period 1777-1791 would see in Wall Street and other trading centres the first USA bull market and collapse (Sobel, 1965, p16).

Despite this set-back, commercial enterprise surged. Banks and insurance companies were established, their shares being traded on stock exchanges. Often it was in the form of a state-chartered company. These companies served as mechanisms to allocate finance in an economically efficient way - with audited reports being seen as a social control mechanism (Flesher et al, 2005, p32-33). Other listed companies were relatively quite small compared to the capitalization and trading volume of the banks and insurance companies. Even these were less important than the trade in government bonds (Sobel, 1965, p24-25; Previts & Merino, 1998, p40). The 1817 war with UK would see USA relying more on its own resources (Sobel, p28).

Various canals and railroads were built with funds from investors. These were sometimes in the form of a corporate charter granted by one of the states. Again audited reports were required (Flesher et al, 2005, p26-32). Sobel (1965, p32-37) details the canal mania of 1812-1830s and the early days of the railway expansion from 1830. The Andrew Jackson Age (1828-1836) was quite turbulent (Previts & Merino, 1998, p65). Jackson was strongly anti-UK, arguing USA economic life was controlled by banks whose management worked with interests from London. In his second administration, the Bank of the US failed to be re-chartered, changing dramatically its role as a national bank (Sobel, 1965, p41-42). It would take several decades before a Federal Reserve would appear (in 1913, see 3.2).

The boom in the period 1834-1837 (Sobel, 1965, p42-44) was followed in 1837\(^2\) by various crises. Crops failed and greedy state legislatures exploited shipping lines. As well, Jackson's administration encouraged reckless over-speculation.\(^3\) The USA economy suffered a near-panic loss of confidence when banks in New York, Hartford and other towns suspended specie payments. Both securities and the government's paper currency became suspect. When Maryland and Pennsylvania repudiated liability on their bonds and promissory notes, USA banking credit in London all but collapsed (Jackson, 1984, p35).\(^4\)

Investment in shares was in decline from 1838-1842 not only from the lack of interest from UK investors, but also from local investors who had lost heavily in the crash. Speculation suffered from a lack of interest. Eventually, the panic subsided and UK investors were assured that various states would honour their bonds. Bond sales in London recovered and stimulated USA stock market investment in railroads, canals, and export merchandise (Jackson, 1984, p36-37).

\(^2\) This was the year of birth of JP Morgan, JP hereafter, and a key stakeholder in the argument in this and following chapters.

\(^3\) Sobel (1965, p49) notes that the banking house Baring Brothers, which helped to finance the historic Louisiana Purchase at four cents an acre, now hesitated to invest further in USA economy. The failure of Middle West grain crops and Wall Street's growing disrepute shook faith in the country's probity.

\(^4\) Sobel (1965, p37) suggests of these times, 'When London sneezed, New York caught cold.'
The panic of 1837 saw financial power in USA being centralised in New York. Other cities, especially Philadelphia, were in decline and the telegraph developed by Morse was adopted by business in general and Wall Street in particular to make it the national market (Sobel, 1965, p52-53).

The Mexican War of 1846-1848 and the discovery of gold in California in 1846 led to further economic prosperity. Speculation and questionable mining ventures followed (Sobel, 1965, p55). As well, on the advancing frontier many settlers sought the rich farm and pasture land. This in turn meant factories to supply farm machinery and manufactured goods and railroads to link the fast-growing townships to the more established cities of the Midwest and the eastern seaboard. Companies were floated, often by shady promoters encouraged by corrupt state officials. In some cases even the share certificates were bogus. Development hinged on two vital elements: foreign capital and an influx of manpower (Jackson, 1984, p40).

2.4.2 Accounting interactions
As was concluded in 2.3.2, during this period Institutional tensions, especially of a professional type, were minimal. Information tensions, however, continued. In UK, the legal profession continued to deal with issues of controls, corruption and limited liability. 'Publicity' was a key issue, though of what was not detailed.

Accounting was also to inform merchants in contemporary terms of the financial position and results for the business (Chambers, 1973, p32). While improvements were made to processing methods, including what were then termed 'modern' items (Baxter, 1956, p282), statements of profit or loss were still not of major concern. Arguably, this resulted from the prevalence of the venture mode of doing business where accounts were not kept by business or company. As well, household and business expenses tended to be intermingled (Hein, 1978, p246-247).

UK ideas were still of influence in USA (Littleton, 1933, p227). However, Flesher et al (2005, p35) concluded USA corporate auditing development in the nineteenth century was also influenced by market forces — economic — and governmental — social — issues independent of, but contemporaneous with, UK debates. Arguably, this might be concluded also of corporate accounting. However, national interests were also evolving.

The expanding railroad industry included in financial statements (from as early as 1830s, see Previts & Merino, 1998, p98) allowances for depreciation and renewals. Arguably, the separation of capital and income of the enterprise was an economic necessity as income (the determination thereof needed for dividend purposes) was in part earned from the use of capital-sourced resources. Limited liability made the

65 In the case of USA, Baxter (1956, p287) listed various economic factors which changed the earlier colonial accounting methods. These factors included the encouragement of more specialized trade, the new currency and the minting of coinage, the establishment of banks and related functions like cheque accounts. He suggests also that a social factor was 'a relaxed tempo in business, and a relish for negotiation ... a more easygoing way of life.'

66 Littleton (1933, p123-154), in a chapter titled 'Development of Financial Statements', refers to works in USA from 1834 onwards. Included was a reference to a balance sheet to show the financial position of the entity.
separation a social necessity as the interests of investors were to be protected by the long-term nature of those capital-sourced resources. The entity became involved in continuing business activities. Thus capital needed to be maintained and reported for both economic and social reasons (Littleton, 1933, p245-247).

While the balance sheet remained the primary statement to be reported, reasons differed between UK and USA. In the former, the report was seen as one of management’s stewardship of the funds provided by shareholders. In USA, the report was directed at bankers who provided much of the capital, more emphasis being on liquidity/solvency issues rather than issues of profitability (Chatfield, 1977, p72).

Failures during the ‘railroad mania’ of the 1840s added to the need for reports of financial matters to provide protection for investors (Lee, 1976, p23). The role of financial disasters would greatly influence the development of both the profession and legislative reporting standards (Chatfield, 1977, p147).

2.4.3 Reporting of liabilities
During this period illustrations of liabilities were well known for recording and reporting purposes. Particular liabilities like notes payable, promissory notes and bills of exchange were well recognized (Baxter, 1956, p283-286). However, debate on issues of principle was scarce, though it was foreshadowed by discussion of attempts by railroad entities to report future renewals (Littleton, 1933, p227).

2.5 The Gladstone Committee of 1841-1844 and Early Companies Acts
The UK legislature and the courts were forced to consider the legal recognition of a general joint-stock business organisation system (Hunt, 1936, p13). In 1841, Parliament appointed a Select Committee ‘to inquire into the State of the Laws respecting Joint Stock Companies (except for Banking), with a view to the greater Security of the Public’ (reproduced in Edwards, 1980a, p4). This was occasioned by scandals and alleged frauds arising from the actions of promoters, especially in the insurance industry. Later, the investigation was broadened to the general regulation of joint-stock companies (Hunt, 1936, p90, p92).

This Committee’s findings culminated in a report 67 of interest to those concerned with general incorporation and issues of published accounting reports. It classified ‘bubble companies’68 into:

1. Those which, being faulty in their nature, inasmuch as they are founded on unsound calculations, cannot succeed by any possibility;  
2dly. Those which, let their objects be good or bad, are so ill constituted as to render it probable that the miscarriages or failures incident to mismanagement will attend them; and –  
3dly. Those which are faulty, or fraudulent in their object, being started for no other purpose than to create shares for the purpose of jobbing in them, or to create, under pretence of carrying on a legitimate business, the opportunity and


68 This classification is used by researchers like Hunt (1936, p92-3) and Hawkins, (1962, p8).
means of raising funds to be shared by the adventurers who start the Company (Edwards, 1980, p6).

Those from the first classification were seen as being beyond the scope of the legislation. It was to be left to investors to decide, publicity being provided in a prospectus which was to be widely exposed. Professional investors would be able to check on the company and perhaps advise less skilled or ignorant investors. Those in the second classification again were seen as being beyond the scope of the legislation. While publicity might not reveal mismanagement, it was argued that difficulties faced by investors would be lessened by the periodical holding of meetings, by the periodical balancing, audit and publication of accounts, and by making the Directors and officers more immediately responsible to the shareholders. Those in the third classification would be remedied by the publication of pertinent information (Edwards, 1980a, p6; Hunt, 1936, p93-94). Legislative action followed.

Controls over the processes of incorporation and promotion were strengthened under general incorporation provisions of the 1844 Joint Stock Companies Act (7 & 8 Vict. c.110) (Haldane, 1970, p12; Hein, 1978, p128), but more importantly for writers like Chambers many years later, unhealthy speculation or fraud was to be minimised by means of publicity (Hunt, 1936, p94; Edey, 1979, p222; Edwards, 1979, p275; Nobes & Parker, 1979, p197). This idea would have significance for later CG reforms.

At the same time, joint-stock companies would be freed from the costly process of having to seek a special act or the like (Hein, 1978, p6), while at the same time raising capital for large scale investments, thus playing a key role in the country’s economic advance. The publicity included a ‘full and fair’ balance sheet which was to be audited. It was argued,

Periodical accounts, if honestly made and fairly audited, cannot fail to excite attention to the real state of a concern; and by means of improved remedies, parties to mismanagement may be made more amenable for acts of fraud and illegality (Edwards, 1980a, p7; Edey and Panitpakdi, 1978, p357).

In this regard, the spirit of the legislation was remarkably similar to more current provisions (Edey, 1979, p222). The theme was that periodical accounting reports provided improved remedies against mismanagement, fraud and other illegalities. These views were incorporated into the Joint Stock Companies Act for 1844. The Act also introduced the phrase ‘full and fair’ as a standard to be met by those preparing the reports.

A proposition mooted at that time was that the privilege of incorporation with limited liability demanded in return the obligation to provide publicly information on the state of the company and its capital but detailed requirements were lacking.69 One witness

69 Of this standard, West (2003, p4) comments, ‘However, a general qualitative standard does not of itself ensure the serviceability of financial reports. That outcome can only be achieved when the technical practices required to be applied to satisfy the standard have been specified and enforced.’

69 This was reinforced in the Report of the Select Committee on Assurance Associations which commented in 1853: ‘One of the chief securities contemplated by the Act of 1844 for the safety of the public is the duty imposed upon them to return annual balance sheets representing the state of their affairs ... they are open to public inspection. But from the fact that the Act prescribed no form, and furnished the Registrar with no power to enforce a compliance with the spirit, or even with the letter of
(a company solicitor) argued, 'The whole proceedings of directors towards proprietors should be a matter of trusteeship, as between trustees and strangers and should not be as between partners and partners' (Cf. Report of 1844, Evidence, Q. 2093, cited in Hunt, 1936, p97, Footnote 23). A stewardship function was suggested.

The 1844 general incorporation legislation (Edwards, 1980, p16-17) was the first of the series of statutes of which there was an underlying philosophy of disclosure rather than direct regulation (Hawkins, 1962, p2). Another period of railway mania followed with a wave of speculation and company promotions (Hunt, 1936, p101). The period 1847-1848 and related failures required the use of financial data in resulting investigations and finalisation of particular bankruptcy cases. Arguably, it assisted accountants to establish solid foundations for professional development (Littleton, 1933, p280). The collapse revealed investor losses and various breaches, especially

- the manufacture of balance sheets to meet registration requirements, and
- the manipulation of profit by the capitalisation of items which might easily be seen as expenses.

Government action was demanded by some but others argued instead it was interference in commercial matters – something to be avoided (Hunt, 1936, p112-113; Edey, 1979, p223).

Parliament supported a laissez faire approach to commerce. It is not to be concluded, however, that debate (sometimes heated) was absent from social reformers (Hunt, 1936, p116-117; Chambers, 1973, p123). As well, debate was had on the role of savings banks, friendly societies and insurance companies in garnering savings from small investors (the 'labouring' or 'working' classes) to be invested in turn into joint-stock corporations. This, it was argued, was the way to effect social betterment (Hunt, 1936, p118-125).

the law, it appears that this provision has been very imperfectly complied with in many cases, and in others altogether neglected; so that it cannot be said that it has afforded, in the majority of cases, either the information or the security which was intended' (Parliamentary Papers [1852-53), XXI, iii, cited in Hunt, 1936, p97, Footnote 25). This lack of required details enforcement provisions is also noted by Edey (1979, p222-223).

71 The Companies Clauses Consolidation Act of 1845 required an audited balance sheet to be presented to shareholders in ordinary meeting (Nobes & Parker, 1979, p197) and allowed the auditors to employ accountants to assist (Edey, 1979, p223).

72 Edey (1979, p223) concludes, 'The first century of general limited liability thus began with companies completely unfettered in accounting matters. The difference between this situation and the scene as we see it today is a significant commentary on the change in political and social outlook that has taken place. Nevertheless, we must preserve our sense of balance. It would not be true to say that responsible men of affairs of a hundred years ago rejected all State control in such matters. Compulsory accounting and auditing requirements were never abandoned in the legislation intended to be applied to parliamentary companies.'

73 Arguably, the more things change, the more things remain the same when consideration is made of current arguments and debates in Superannuation and Pension Fund investments (The Economist, 2006d, p60-61).
Around 1849, various statutes since 1813 related to the winding-up of corporations were amended. The resulting conflicts of jurisdiction (between the Chancery and the Courts of Bankruptcy) caused great confusion which proved highly beneficial not only to the legal profession but also to accountants, as various questions of a financial type required testimony on accounting matters (Goldberg, 1949, Part III). Organised professional accounting groups would become a major pressure group in issues of management in general and reporting in particular (Littleton, 1933, p282-284).

Links strengthened among parties from UK and USA. On his first visit to London in 1850, the British capital's financial district – still today referred to as the City of London – impressed Junius Morgan (JP's father). Here some control in a governance sense was exercised by the informal links among bankers, including George Peabody, USA ambassador and highly respected in banking circles. Junius joined Peabody & Co in London in 1854 (Sobel, 1965, p36-37; Jackson, 1984, p41).

In 1855, the Limited Liability Act (18 & 19 Vict. c.133) introduced the principle of limited liability within general registration (Nobes & Parker, 1979, p197). While directors were still liable in cases such as the payment of dividends when the company was insolvent, it was envisaged that the major control would be the use of the term ‘limited’. It was argued that those who dealt with companies knowing them to be ‘limited’ had only themselves to blame if they lost money. The term ‘limited’ was to act as a ‘red flag’ to warn of the dangers faced if dealing with this type of entity (Goldberg, 1949, Part III). Caveat emptor in corporate relationships now dominated. It would take further instances of company promotion/attendant evils for sufficient stimulus to be provided for a framework of regulation to limit the doctrine of caveat emptor for application to investors (Hunt, 1936, p139).

The act was not developed independently, adding simply to the 1844 Act. However, the push for laissez faire was effective. By 1856 most of the privileges to be inherent under incorporation had been granted. The trend of future legislation was to add restrictive measures aimed at control, including those of information to be given to present and potential shareholders in the forms of the prospectus and financial reporting (Hein, 1978, p130-131).

1856 produced a Joint Stock Companies Act (19 & 20 Vict. c.47) with a different philosophy which deleted the compulsory accounting and audit requirements. These were placed in an accompanying Table B as a desired model set (Edwards, 1980, p19-24; Hein, 1978, p136; Nobes & Parker, 1979, p197; Edey, 1979, p224). Except for banking and insurance companies, financial statements had to be published only

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74 This control was in the form of a gentlemen's agreement. Chambers (1991a) refers in argument to the motto of the London Stock Exchange - 'My word is my bond'. This philosophy would be later suggested for controls in finance (JP later) and accounting (May later). Their arguments were consistent with a general push for a laissez faire approach to the control of commerce, as noted above.

75 A similar argument was to be used some 70 years later in the USA with respect to the use of the phrase 'accepted accounting principles', a phrase which purportedly was to be a 'red flag' to non-accountants (May, 1943, p42).

76 Of interest regarding the valuation of liabilities was the requirement for actuarial valuations (Nobes & Parker, 1979, p198).
where the company's articles of association so required (Hein, 1978, p76-77; p136-137). Edey and Panitpakdi, (1978, p 361) commented,

The abandonment seems to have been the result of the strong contemporary feeling that matters of accounting should be dealt with by private contract between shareholders and directors ... combined with the ineffectiveness ... of provisions written into the 1844 Act.

Others would link it to the enthusiasm for the promotion of industrial expansion (Hawkins, 1962, p13). However, the 1856 Act did retain a general qualitative standard for reporting; the phrase now reading 'true and correct'.77 There was a move away from managers-as-trustees-for-shareholders to an (often implicit) contract relationship between management and shareholders.78

The following years saw a series of speculative manias (Aranya, 1979, p266). UK investors quickly felt the effects of an 1857 USA panic. As well, a depressed Europe was linked to the UK financial structure almost collapsing.79 In 1862, a Consolidating Act (25 & 26 Vict. c.59) was enacted, setting the basis of control until the next century.

A banking crisis of 1866 saw the demise of Overend, Gurney and other banks, leading to substantial losses for investors and a climate of distrust (Littleton, 1933, p271-273; Hunt, 1936, p153-154; Hawkins, 1962, p14-15; Sobel, 1965, p88; Chatfield, 1977, p147; Aranya, 1979, p266). The significance of unpaid share capital was highlighted as issued shares had been paid to only a fraction of the stated amount. UK investors were forced to sell USA securities to meet their commitments which in turn had repercussions in USA. The House of Commons appointed in 1867 the Watkin Select Committee on the Limited Liability Acts (Hunt, 1936, p154; Edwards, 1980, p14) as limited liability and the formation of joint-stock company had become extremely unpopular socially. However, the prevailing policy continued to be non-interference by government in the periodic reporting by general business companies.80

An increase in world trade and an upswing of prices in the late 1860s presaged boom times, sustained into the early 1870s by railroad building in USA. A slump began in 1873, lasting some five years (Vallance, 1955, p34). It would claim as a major victim the City of Glasgow Bank (CGB, see 2.6).

At the meetings of the Select Committee on the Companies Acts, 1862 and 1867 (Edwards, 1986, p94-117), for the first time serious consideration was given to the

77 The original 'full and fair' phrase has been recycled by those seeking reform of reporting to all stakeholders other than that between management and shareholders (Estes, 1996, p206 et seq).

78 Interestingly, this approach was later a key part of Agency Theory in general and Positive Accounting Theory in particular.

79 Indeed, it led to Marx' famous prediction of the end of capitalism (Sobel, 1965, p61).

80 However, selected industries like financial institutions and public utilities did come under more stringent control. The Regulation of Railways Act of 1868 (Edwards, 1980, p174-187) required detailed published accounts, including that the balance sheet be divided into a fixed capital section and a circulating capital section (Hawkins, 1962, p16-17; Hein, 1978, p77).

2.5.1 The USA scene

Although by 1812 some states (including New York) had enacted laws on general incorporation which included provisions on limited liability, general acceptance did not occur until the 1850s (Sobel, 1965, p23). In the meantime, rail stocks were at the forefront of new issues to finance development. The banking industry also greatly expanded (Sobel, 1965, p56-57).

Mirroring UK economic boom-bust activity, investor confidence, at a high in 1853, suffered with the USA 1857 panic following various collapses due to mismanagement and fraud (Littleton, 1933, p273; Sobel, 1965, p60-63; Flesher et al, 2005, p35). Demand for USA wheat collapsed after the Crimean War ended - an early blow to an overheated economy. Many small Western banks, having recklessly backed speculative ventures, suddenly found it difficult to recover their loans or unload their debtors’ notes on Wall Street, even at heavy discounts. Mismanaged railroads and undercapitalised factories and stores went bankrupt and hapless investors ruined in both UK and USA (Jackson, 1984, p56-57).

The economic slump was short. During this period, the ‘Robber Barons’ appeared on Wall Street (Sobel, 1965, p63; Josephson, 1934, p5-9; Previts & Merino, 1998, p103) - a new breed of brash promoters. Some states sought regulations to control new securities issued by public service corporations – in the first instance, railroads. The statutes were not designed primarily to protect investors from fraud, but to monitor the costs and character of the service performed by public service corporations – arguably a social issue. While rates would not be set, it was argued that publicity and related adverse public opinion would control those charging inequitable rates (Hawkins, 1962, p127, 129-132).

From 1858-1861, economic caution followed debates between South and North supporters of irreconcilable social positions (Sobel, 1965, p67). Later, towards the end of the Civil War, JP saw the need for capital to meet any reconstruction of industry. His reputation grew for the ability to analyse the most complex balance sheet and extract a very practical plan of action, often without time-wasting civilities (Jackson, 1984, p62, p82).

The Lincoln inauguration and the Civil War which followed presaged a golden era of speculation and financial wrong-doing (Littleton, 1933, p273; Sobel, 1965, p71-73, p109). Ties between the North and the West strengthened, industrial output grew,

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81 Sir George Jessel, the Master of the Rolls, chief public official in charge of the dissolutions of companies was of the opinion that any protection of shareholders via financial statements was simply an illusion (Edwards, 1986, p117). He also claimed ‘Profit of course is a mere matter of estimate’ (Cited in Hein 1978, p249-250).

82 Included was Jim Fisk, a former circus barker turned theatrical impresario. He took over the undervalued Fall River Steamboat Line. Another, Daniel Drew, began to float companies that offered extravagant dividends on insignificant, often quite imaginary assets. Another was Jay Gould, who was arguably subtler and more dangerous (Jackson, 1984, p58-59).
business (especially related to the railroad industry) flourished, both regarding goods and in bond sales to the public necessary to finance the Union’s expenditures. While some thought the government’s deficit budgets financially unsound, inflation and prosperity followed. The seeds of people’s capitalism were sown from the public’s response to various share and bond issues (Sobel, 1965, p69-70). Bullion backing for government paper saw a volatile market in gold and questions of the control of speculation were raised in the popular press (Jackson, 1984, p65, p74). In 1864, Congress legislated to stop gold-futures trade but it was unable to close the many loopholes. The act was soon repealed (Sobel, 1965, p74-75).

Consistent with contemporary UK ‘free trade’ ideas, JP argued strongly against any attempt to regulate business. Conservative UK finance houses (like Rothschild and Barings), cautiously awaiting the outcome of the war, were suspicious of the paper currency from Washington. They also disapproved of Wall Street’s feverish speculation in gold, receiving reports from reliable agents which confirmed widespread civic corruption over land grants and franchises (Jackson, 1984, p76).

After the Civil War, growth in investment in manufacturing as well as agriculture and mining ventures was financed in part from UK investment (Sobel, 1965, p81). The post-war surge was built primarily on the railway expansionary boom. Some attempts to demand information were made. In 1869 the NYSE established the Committee on Stock List. The committee required listed companies to publish some form of an annual financial statement. Not all companies agreed and it would be 1897 before a corporation’s financial report would be published (Hawkins, 1962, p242-243; Sobel, 1965, p85-86).

This period, termed the ‘Gilded Age’ (Previts & Merino, 1998, p103-104), saw heavy investment, especially in railroads, and a switch in financial power. Support previously provided by small state banks now came from large financiers and banks. The latter were able to finance what has been described as a phenomenal industrial boom generated by inventive geniuses - the surnames Bell and Edison were to become household names like McCormick or Rockefeller, whose surnames had become synonymous with the corporations International Harvester and Standard Oil respectively (Gross, 1996, p23-38; p41-57).

However, railroad shares and municipal bonds continued to be viewed with suspicion by investors. Various suspect practices were followed and corrupt political backing was provided by groups like Tammany Hall in New York. JP tended to avoid any involvement in unseemly ‘publicity-mongering’. Railroads were to be the source of a major battle between JP and the Gould-Fisk interests. JP provided a scheme to salvage the Albany & Susquehanna line from it falling into their hands, partly as he scorned them as scoundrels which in turn led to his scorn for politicians. JP’s actions helped his reputation on Wall Street. However, this event was overshadowed by another bull market in gold and its eventual collapse in 1869 with the usual disclosure of

83 Jackson (1984, p83) suggests this switch was compounded by the financing of ‘shady companies [which] would seldom have stood up to proper auditing.’

84 These included stock watering in the Erie Railroad cases and the use of a dummy company such as Credit Mobilier in the Union Pacific case.

The French-Prussia battles in 1871 saw for the first time the House of Morgan become involved in international finance (Jackson, 1984, p95). JP's previous firm was dissolved and Drexel, Morgan & Co established. This new firm quickly made its name well known.85

Boom-bust activity continued. 1873 was the start of another recession (Sobel, 1965, p97-98). Banks restrained credit, Wall Street prices dropped and UK investors became once again wary. For the first time the NYSE closed. Some like Gould continued to prosper, helped by the use of his own paper86 in New York to push various stocks or bonds to his group's advantage.

The following five-year87 slump 'spared only those with ample capital and strong nerves.' Included of course was JP's firm. However, his judgment of others was arguably flawed as all politicians were dismissed as either self-important fools or knaves who sold their principles to the highest bidder (Jackson, 1984, p103-105).

Despite his views of politicians, JP maintained contact with various administrations. He solved a payroll crisis for the Hayes administration in 1877 (Gross, 1996, p64). However, uneconomic railroad fares and freight charges, union campaigns for higher wages and potential changes in monetary policies by the Hayes administration (especially regarding the issue of silver dollars) suggested difficult times ahead. While JP had been mainly dealing in foreign exchange and government bond issues, in 1879 he was unexpectedly involved in a railroad deal that would transform the industry as well as adding an entirely new dimension to merchant banking (Jackson, 1984, p115-116) in the final two decades of the century.

2.5.2 Accounting interactions
As regards Institutional tensions, infrastructure issues were minimal. However, at the professional level, this period saw the formation of professional groups of accountants in Scotland (Edinburgh, 1854, Glasgow, 1855) and in English cities (1870-1877). In 1880, those in the English cities united to form the Institute of Chartered Accountants in England and Wales (Brown, 1905; Littleton, 1933, p265, p268, p305, p315; Howitt, 1966).

85 The second Grant administration issued a new series of government bonds and the financier Cooke, needing funds to support his new and not so successful investments, sought a monopoly on their underwriting. Cooke's group was opposed by Drexel, Morgan & Co who used a press campaign hostile to Cooke's group (Drexel's own influential newspapers) and JP's skills in organising a banking syndicate to obtain a share of the marketing of the bond issue (Sobel, 1965, p109).

86 Gould obtained a controlling interest in the New York Tribune (which had been critical of his actions) and used it to voice his own interests. Indeed, he was not above its use to discredit management of corporations he wished to take over (Sobel, 1965, p115-116).

87 Sobel (1965, p100) suggests it was for six years.
During the first five years, the professional journal *The Accountant*, (established in 1874) was mainly concerned with issues of an institutional type. Littleton (1933, p315) listed them thus:

- bankruptcy statutes and court cases matters,
- disputes between lawyers and accountants regarding their fields of work, and
- the need for professional accountants rather than amateur auditors.

Information tensions also developed, but any guidance by statute tended to deal with form and content. To Littleton (1933, p205-206), one interaction was the need in the now expanding corporations for accurate and economical recording of the large volume of transactions. To him, any resulting reporting by management to shareholders was a 'means of control'.

In early Companies Acts, the balance sheet continued as the dominant accounting report. It was designed to give investors information on the financial position of the company at a certain point in time. The 1856 Act had included a model balance sheet which separated assets and liabilities into fixed and current (Edwards, 1986, p9). The link to the accounts from which it was derived was to some a process of evolution from the double-entry system of bookkeeping:

- debit and credit,
- trial balance,
- balance account,

However, a statement of financial position might also be prepared under a single entry system by listing and valuing assets and liabilities (Hein, 1978, p184-189). Indeed, the later Davey Committee (see 2.6) received testimony which recommended (instead of a balance sheet) a statement of assets and liabilities be required (Hein, 1978, p237; Edwards, 1986, p130).

Others were more strident in their criticisms. Jessel, then Master of the Rolls, the chief public official in charge of dissolutions of companies, testified that he had utter distrust of accounts in general and a balance sheet in particular (Edwards, 1986, p117; Hein, 1978, p196-199).

Some appreciation of the limitations of accounting reports was acknowledged, especially in the case of readers inexperienced in business (Edwards, 1986, p115, p117).

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88 This was consistent with responses to earlier UK findings (recall 2.4) of fraudulent accounts being kept by unregistered joint-stock partnerships.

89 In Chapter 4, it is shown that in the 1920s, after some fifty years of discussion, the statement of profit and loss was to replace the balance sheet as the report of principal interest.

90 Arguably, this separation was introduced from the ideas from UK classical economists of fixed and circulating capital (Chatfield, 1977, p71).

91 As will be seen in Chapter 4, the two reports were not necessarily seen by practitioners as being synonymous.

92 West (2003, p54) would later raise Lenin’s view that accounting was not a matter of expert knowledge but easily grasped by any literate person.
Debate was also held on whether income or capital could be determined with sufficient accuracy to legislate to prevent abuses where dividends were paid out of capital (Edwards, 1986, p101-102, p111 et al; Hein, 1978, p189-190). Littleton (1933, p216-217) found that in the 1850s, the balance sheet was used to calculate ‘net revenue’ or ‘net profit’. This, he stated, was a concept of profit associated with liquidation (or winding-up) of a corporation. He found this unsatisfactory in terms of a going-concern. To him, the ‘modern’ problem was to ascertain ‘income’ – a term to do with continuity. ‘Profit’, on the other hand, was a term to be used without the constraint of being associated with particular periods.

The debate was the subject over following years of various legal cases and included issues debated to this day on the maintenance of capital, especially in times of changing price levels, and of seeking sustainable development.

2.5.3 Reporting of liabilities
The original draft bill of the Act of 1844 simply required the disclosure of debts due by the Company at the date of making such balance-sheet. However, this requirement was deleted from the Act. In the Acts of 1856 and 1862, the model balance sheet required the subdivision of liabilities into what are now called fixed and current categories and required contingent liabilities be shown below the footings to the balance sheet (Edwards, 1986, p110). Debate was found as to whether practices of the time met these standards (Hein, 1978, p231-232).

Not surprisingly, given that one catalyst for the 1841 Gladstone Committee of Inquiry was collapses of insurance companies; of interest was the requirement for directors of an insurance company to make provision for probable claims on policies before declaring any dividend (Littleton, 1933, p220). Implicitly, the definition of liability was being broadened.

2.6 The Excesses of the late 1800s
During this period, the lack of compulsory audited financial information saw the weakening of shareholders’ legal position. At the same time, management could claim a need for secrecy, even in cases where shareholders sought information at annual meetings (Aranya, 1979, p266). Various crises continued.

The failure in 1878 of CGB occurred, as pointed out in 2.5, during a downturn in the economic/trade cycle. The preceding boom had seen the bank emerge with four large accounts with merchants involved in the East Indian trade who were friends of board members. With the slump, all four accounts required assistance. Management extended assistance by increasing the overdrafts. It was argued that this was seen as most imprudent in banking circles of the time (Wallace, 1905; Rosenblum, 1933, p285; Vallance, 1955, p36-37; Hawkins, 1962, p17).

In 1878, rumours of disquiet circulated as the quantity of CGB acceptances in the market increased. However, published reports revealed no apparent weaknesses and the usual dividend declared. Given the 40-year history of the bank, its paid-up capital

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93Littleton used the case of a rented/leased property – ‘income’ was the periodic rent while ‘profit’ related to a gain on the resale of the property.
of an unlimited liability type, reported deposits and directors of repute, the rumours seemed unsubstantiated. Later that year, after CGB did not open its doors, a Committee of Investigation was appointed. It was reported that the bank had large losses and instances of both mismanagement and malpractice were found (Rosenblum, 1933, p286; Vallance, 1955, p34-35; Haldane, 1970, p53-54).

The mismanagement was in both reckless lending via overdraft to traders and the speculative nature of some investments (ranging from USA railways to Australian land deals). Malpractice apparently had begun in 1876 when management changed a draft balance sheet from the bank’s accountant to ‘improve’ the position of the bank. The figures were manipulated to conceal the actual position (Rosenblum, 1933, p286-289; Vallance, 1955, p38; Haldane, 1970, p60-62; Tyson, 1974; Sykes, 1988, p109). Each ensuing year the problem became more unwieldy.

Although management and directors were convicted of criminal acts to defraud shareholders and the public by falsification of accounts for 1876, 1877 and 1878, the comparatively lenient sentences suggested to some that they were victims of the economic climate of the day (Vallance, 1955, p34, p40-41).94

The case added to questioning of the information provided by companies (Chatfield, 1977, p147). The revelations highlighted an input-domination of reports produced by accountants. In the legal summary, reference is made to the difficulty faced in the interpretation of accounting-type evidence. Evidence was given that the bookkeeping procedures followed resulted in various outcomes. It was argued that the balance sheet was in accord with the books, thus truly reflecting the procedures followed within the bank.95

In 1890, fraudulent schemes among a group of companies centered on the Liberator Permanent Benefit Building Society were discovered after its failure, leading to bankruptcy and a criminal trial. The fraud covered a period of twenty-five years which included three booms and slumps, in 1872, 1882 and 1890 (Vallance, 1955, p42-44).

While again the offences involved the falsifying of books (and fraudulently taking illegitimate commissions), of interest was the arbitrary writing up of the book value of assets and the use of groups of related companies to sell property at often an artificial price (and related profit).96 As well, inter-company finance was exploited by cheques

94 Arguably, the case led to the requirement of a compulsory audit being imposed on banks under the 1879 Companies Act (Nobes & Parker, 1979, p198). The Davey Committee (1895) and the 1900 Companies Act would subsequently recommend it for all registered companies (Hein, 1978, p151; Edwards, 1980a, p25; Edwards, 1980, p31).

95 Reasoning similar to this would be presented by those in the accounting profession to the various committees set up in times of reform and seen to be required after many major collapses of corporations, whether due to mismanagement, fraud or other reasons. See for example Sykes (1988, p128-129).

96 Edwards (1979, p276) argues the permissive nature of the time allowed management to ‘publish a profit figure sufficient to cover the payment of the annual dividend, rather than a profit figure which fairly reflected the economic activity which had occurred during the accounting period.’
being exchanged among related companies, sometimes using a bank established by the group to facilitate these movements (Valiance, 1955, p44-46, p48-49). Intercompany shareholdings were not prohibited and by the 1890s were fairly common (Walker, 1978, p20).

A growing number of abuses suggested reform of company law was required, leading to the 1895 Davey Committee of Inquiry (Hawkins, 1962, p20-21; Edwards, 1980a, p23). However, there was not complete disillusionment with the aims of the Companies Acts. Limitations, including the lack of protection of investors from abuses, had to be balanced with the need of new capital. It was argued emphasis be placed on cases of successful, legitimate commercial enterprises which had supplied investors with full and complete information. Here it was found disclosure was not contrary to investor interests. Required was the adoption, by all companies, of the disclosure practices of the honest companies, perhaps voluntarily. If not, a modification to the existing company law had to ensure honest, legitimate companies were not injured (Hawkins, 1962, p23-24).97

The Davey Committee sought to balance the required protection of the investing public with the need for companies to raise the funds for investment. It recommended stockholders receive an audited balance sheet but was unable to make any recommendations on the computation and reporting of income.98 Certain particulars of the balance sheet were made compulsory. It was pointed out that experienced accountants had sat on the Committee so that any recommendations related to financial accounting had some standing (Hawkins, 1962, p27; p30-31; Aranya, 1979, p267).

The resulting 1900 Companies Act continued the pattern for subsequent legislation in the area of security regulation, one based on the so-called philosophy of disclosure (Hawkins, 1962, p32). The approach was seen as being in contrast with the USA approach of supervision (Manley, 1976, p60).99 Walker (1977, p78) argued the 'philosophy of disclosure' approach was at best an overstatement of the case. Instead, Walker concluded that the evidence found in the various Companies Acts supported a claim of disclosure rules being established, but this did not evolve into a disclosure policy. Walker (p80) instead concluded from his analysis (p78-80),

*The history of British company law is hardly consistent with the claim that British governments espoused a 'philosophy of disclosure'. A more plausible interpretation is that the legislature resisted demands for fuller corporate accountability and was sympathetic towards appeals for business privacy.*

Similar arguments will be met in later Chapters.

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97 This was established by the pro forma honesty statement that would be required from directors. It would recur in following Acts and supported in the related Committees of Inquiry.

98 Edwards (1980a, p26); this later became work for a select group of experts.

99 Manley was writing of the Hatry case which is returned to in 4.2.1.
2.6.1 The USA scene

A strengthening of USA influence in corporate affairs, relative to that of UK, was noted. Business in general and accounting in particular were provided with much more prominence in USA than that generally found in UK.\textsuperscript{100} Unusual weather patterns in UK and Europe in 1879 – snow in July – destroyed crops there. This ensured boom times in USA which enjoyed high crop harvests and prices. Debate on a return to the gold standard was won by those who sought a ‘sound dollar’. While investment bankers were not new, they became the vanguard for a bull market (Sobel, 1965, p105-107).

Litigation on Commodore Vanderbilt’s estate resulted in a decision to sell part of its railroad empire, essentially the New York Central. JP organised a syndicate for the deal and was appointed to the board. A precedent was established by this huge sale of securities by private negotiation (Sobel, 1965, p108). In the past, Wall Street finance houses had been content to act as agents or intermediaries for a commission, with banks pursuing their traditional role of moneylenders to promoters.

JP realised a finance house like his, if backed by powerful muscle, might secure company directorships. Further, in the case of less powerful corporations, managerial control might be seized from boards lacking working capital in periods of crisis. Board power could then be exercised for the judicious issue of stock (with almost limitless scope) to amalgamate weak units. Struggling railroads could be made into cohesive profit-making corporations to attract investors disillusioned by men like Gould. JP perceived the blueprint of the strategy that would transform the whole field of investment. This was to become known on Wall Street as ‘Morganization’ (Sobel, 1965, p147-173; Jackson, 1984, p122-123).

To JP, a balanced railroad system was necessary for the national economy.\textsuperscript{101} Of related concern was that two most powerful industrialists, Carnegie and his steel monopoly and Rockefeller’s Standard Oil,\textsuperscript{102} extracted preferential treatment for their freight. Weaker competitors were eliminated and harsh conditions imposed on the often hapless work force (Jackson, 1984, p124-125).

As mentioned earlier, JP’s snap judgments were often based on his instinctive likes or dislikes, including of a person’s social background and business record. The record of the Republican candidate in 1884 being rather suggestible, JP preferred the Democrat Cleveland for president (despite his low-tariff policies) who, on election, inherited a legacy of high unemployment, rising prices and acute labour unrest. Wall Street,

\textsuperscript{100} This would continue over time, as for instance, Handy (2001, p125-126) while discussing his version of USA capitalism, recalls what he saw as a difference between USA and UK conditions, ‘I was going to the Massachusetts Institute of Technology to learn the theories and practice of business in the land where, I gathered, business and the schools of business were universally admired. It was different in Britain in 1966. There were no proper business schools, and business was not thought worthy of serious study. When I told a friend that I was going to MIT in preparation for joining the new London Business School, he looked puzzled, then asked if MIT stood for the Montreal Institute of Typing. Back then, to most people in Britain, a business school meant a secretarial college.’

\textsuperscript{101} However, some reporters were to question the pricing of tariffs and fares, leading to Vanderbilt’s famous retort, ‘The public be damned!’ (See Sobel, 1965, p115).

\textsuperscript{102} This company controlled 95 percent of refining capacity in USA.
already overextended by wildcat railroad finance, was soon rocked by scandals (Jackson, 1984, p136-137) and the panic of 1884. Faced with another railroad battle, JP applied his voting trust formula, claiming a monopoly eliminated waste and inefficiency and was thus beneficial to the shareholders and management (Sobel, 1965, p120-121). Others remained unconvinced, including passengers who would pay higher fares, workers who were less able to bargain for shorter hours and better pay and, above all, the smaller companies who now faced rising freight costs while monoliths like Carnegie and Rockefeller enjoyed privileged rebates (Jackson, 1984, p143-144).

Cleveland’s administration was expected to change particular government policies. The foreshadowed changes turned to be illusory, as Cleveland was happy with the previous system. He simply tried to make it more efficient. While not pro-business, his laissez faire policies during 1884-1896, as summarised by Sobel (1965, p126), saw ‘greater social and economic concentrations develop than at any other time in the nation’s history.’

Dealing with economic and social discontent was considered beyond the scope of government. Farmers were in relative decline, workers in an industrial society faced problems and big business was expanding. Special interest groups were formed, some becoming quite powerful (Previts & Merino, 1998, p105). The Populist Party was formed, becoming the voice primarily of the farmer group. Some business groups formed pools to discourage competition and price cutting, thus maximising profits.

The Interstate Commerce Act (ICA) (which marked the start of new industry-government relationships) declared pools in the railroad industry illegal, leading to a decline of the use of that instrument. Instead, a trust formula was used (Sobel, 1965, p126-128, p177).

The trust method became more potent after the passage in 1889 of a statute in the state of New Jersey permitted one corporation to hold shares in another corporation - a

103 It included the demise of the former President’s firm Grant and Ward. Ward was quite a criminal, seeking and allocating investment in various financial schemes which promised investors high yields – which he did by paying dividends out of capital. A series of firms collapsed as a result (Sobel, 1965, p118-119).

104 Some ‘loose’ reporting methods were allegedly used to account for these rebates (Gross, 1996, p46-49).

105 Walker (1978, p122, footnote omitted), ‘The railroad industry was at times fiercely competitive – with corporations striving to defeat competition and subsequently maintain a monopolistic situation. Attempts at exploitation in these situations were responded to by state regulatory action – and later in 1887 by the passage of the federal Interstate Commerce Act.’

106 Walker (1978, p124, footnote omitted) writes, ‘Regardless of whether the new Jersey enactments were a calculated stand against “the hysteria of the times” [Footnote omitted], a sophisticated attempt to aid business interests or simply a crude effort to garner the revenues obtainable from corporate registrations, the extension of corporate powers in this direction offered hope of evading the anti-trust legislation.’

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practice previously considered grossly improper, being sanctioned only rarely by special legislation. What followed was the establishment of a holding corporation in New Jersey,\(^{107}\) the takeover of various others by issuing shares in the holding corporation and the establishment of a conglomerate, perhaps big enough to capture the national market.\(^{108}\) By 1892, large companies were publishing consolidated statements (Hein, 1978, p273).

Various financiers like JP used the corporate form of organisation to create extremely large and formidable conglomerates (Littleton, 1933, p9; Sobel, 1965, p128-129; Previts & Merino, 1998, p107-108). The work of people such as Poor, Moody and Dun sought to provide stakeholders in general and shareholders in particular with data on those organisations (Sobel, 1965, p131-132, p175-177). Practices such as pools and corners, mismanagement and outright fraud saw the establishment of the Interstate Commerce Commission (ICC) (Littleton, 1933, p236). Congress attacked the growth in trusts, particularly in the railroads, as their consolidated systems controlled 45 percent of the country's entire mileage. President Grant supported the enactment of the ICA by which secret rebates and the like were to be made illegal. However, cases brought by the commission were usually lost on appeal to the Supreme Court (Jackson, 1984, p147).

*Caveat emptor* and *laissez faire* remained to the fore. In private, JP again attacked government interference in business. He supported the Republican Harrison, the successful candidate in the 1888 election. His administration hopefully would check the growth of the new Populist movement\(^{109}\) which pledged to destroy Big Business, trusts, and monopolies. JP dismissed it as typical of the new anarchy and no threat to his 'Morganization' (Jackson, 1984, p148). JP did not foresee the tempering of the goals of the Populist movement into one of social control over various excesses.

By 1889, many of the smaller railroad lines were bankrupt following rampant over-speculation and mismanagement. Investor confidence in Wall Street (and the City of London) was low (Sobel, 1965, p133-134; Jackson, 1984, p148-149). To JP, this situation called for Morganization, leading to what was called the 'Gentlemen's Agreement'. Congress, labour leaders, and industrialists like Carnegie and the Rockefellers were reminded that JP had for the first time clearly identified himself as the champion of investment power. This power could be imposed on stockholders and independent operators alike. Edison, for one, soon learned that Morganization would not be restricted to the railroad business (Jackson, 1984, p150).

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\(^{107}\) May (1936, p40), writing in 1926, referred to 'a somewhat undignified competition for new incorporations' by that state.

\(^{108}\) Arnold (1937, p193) commented: 'Laws against monopoly and restraint of trade were easily evaded in the fairyland where men pretended that organizations were men who owned property. Nothing in the Middle Ages compares for sheer fantasy with the holding company, or with modern security manipulation by which control of large organizations may be obtained without investment risk. Equally fantastic was the notion that a corporation had the rights of a citizen of the state which incorporated it.'

\(^{109}\) Although Cleveland would beat Harrison in the 1892 election, the Populist Party polled well in popular vote as well as winning the electoral votes in four states (Sobel, 1965, p135).
Edison and the growing Insull empire\(^\text{110}\) became a focus of JP’s investment activities. Insull exhibited talents in organisation and skills in business, even besting JP in various ways regarding Edison companies which became large USA utility groups. One contribution attributed to Insull is the use of the open-end mortgage by which debt could be continually refinanced (Sobel, 1965, p243). Insull’s activities are returned to in 4.2.

Despite the ‘Gentlemen’s Agreement’, railroad failures continued and UK investors again became wary. Public disquiet supported reforms like the Sherman Anti-trust Act.\(^\text{111}\) Political debate and potential action continued regarding the silver-gold policy as \textit{specie} payment to support the USA currency (Sobel, 1965, p136-139). As well, economic and monetary crises occurred in Argentina. The old established London house, Baring Brothers, suddenly faced insolvency as they carried huge blocks of unsaleable Argentine bonds and had liabilities of over L20 million.\(^\text{112}\) The Morgan firms joined an international guarantee fund to resolve the Baring’s crisis, promoting JP’s name into the highest echelons of international banking (Jackson, 1984, p156-157).

When the Cleveland administration regained office in 1893, it once again inherited an economy in disarray: the free coinage of silver, a parallel drain on gold by nervous foreign investors, the failure of almost 600 banks, the halving of most Wall Street stocks, a rise in food prices, a slump in wages and soaring unemployment (Jackson, 1984, p166-167). At the same time, some businessmen dealing with the railroads and other public service corporations were becoming disillusioned, at the state level, with the use of \textit{publicity} as a rate-controlling device. Agitation arose for more stringent and direct government control of such companies (Hawkins, 1962, p131-132). Despite this, JP planned a reorganization of Northern Pacific.

However, a gold crisis intervened in 1894-1895. The administration sought to issue more gold bonds to avert imminent bankruptcy and preserve national honour and credit (Sobel, 1965, p121, p141-143; Jackson, 1984, p171). Local and international investors were unimpressed with the terms. JP’s firm\(^\text{113}\) proposed to the administration

\(^{110}\) Sobel, (1965, p243): ‘In 1892 he went to Chicago as head of the Chicago Edison Company, and within fifteen years had organized the Commonwealth Edison Company as one of the nation’s largest utilities. Insull made several important contributions to American business ideology and practice in this period... He expanded Commonwealth’s coverage greatly, bringing electricity to areas which other utilities ignored for reasons of economy. Insull believed that through rapid but careful expansion and full utilization of plant, rates could be lowered and profits increased at the same time.’

\(^{111}\) Walker, (1978, p122), ‘Public hostility towards monopolistic practices was focussed on the activities of a variety of so-called “pools” and “trusts”.... Antagonism towards pools and trusts was reflected in state laws or amendments to state constitutions aimed at banning combinations. In 1890 the federal legislature passed the Sherman Anti-Trust Act.’

\(^{112}\) Green & Moss (1982, p9) comment, ‘The difficulties of Baring Brothers, the old-established London merchant bank whose South American commitments were in jeopardy during 1890, had thrown the investment and banking world into confusion. The position of Barings was eventually safeguarded by intervention from the Bank of England and the commercial banks, but trusts such as the Government Stock were left with seriously depreciated securities.’ The Government Stock and Other Securities Investment Co was established in 1871 to invest in government or government guaranteed securities. Interestingly, no such rescue would be forthcoming in the 1990s when Barings collapsed after traders in derivatives produced losses approaching US$1bn (Hogan, 1997).
a private syndicate to sell the bonds. Cleveland rejected the plan, but JP persisted, his personal guarantees to the President being a keen part of Cleveland's final acceptance of that offer (Gross, 1996, p65). Resistance to a second private syndicate, however, was widespread, receiving support from parts of Congress and the popular press, leading to JP eventually dissolving the syndicate.

JP was thwarted also in his plans for the railroad industry. However, this was not of the same importance to him as the replacement of Cleveland with a Republican administration dedicated to the gold standard. JP eventually supported McKinley who, with a long congressional record, made a safe candidate who pledged to support gold. He also attracted hundreds of thousands of campaign dollars from the beef and sugar trusts, Standard Oil, and Carnegie Steel (Sobel, 1965, p147-149; Jackson, 1984, p187).

McKinley's 1896 administration included as Assistant Secretary of Navy Theodore Roosevelt. JP was one of many Republicans startled by Roosevelt's term as New York's police commissioner. While agreeing with reform of the police force and an attack on Tammany Hall's corruption, slum clearance came uncomfortably close to Democrat-type social policies. Roosevelt was to resign and participate in the Spanish-American war. The resulting USA dominance over the former Spanish colonies had implications for Wall Street as it coincided with USA's debut in global finance as a lender rather than its traditional borrowing role (Jackson, 1984, p190-191).

The McKinley Republican administration saw no need for any government action as it was in part guided by a group which believed that what was good for large corporations was in turn good for the country. The administration made impotent the Sherman Antitrust Act and encouraged the strategy of forming conglomerates via stock ownership. 'Morganization' expanded. JP's firm tightened its hold on the country's major railroads, directly or as fiscal agents. It dominated the policies of General Electric, International Harvester and Western Union. It expanded its investment in life insurance companies, providing banking muscle and financial expertise to the plans of others. The future United States Steel Corporation for example would follow and become the world's first billion-dollar merger (Jackson, 1984, p191, 197-208). Indeed, Sobel (1965, p147-173) titled his Chapter 9 The Morganization of America: 1896-1903.

113 The firm was now named J.P. Morgan & Co after the sudden death of Drexel.

114 This was an earlier version of the mid-twentieth century claim "What is good for GM is good for the USA".

115 Berle (1954, p45-46) commented, 'The result of the competitive system when many units were involved was to push out the least efficient units, or perhaps the worst-placed strategically. The result of great corporations fighting each other is either consolidation, or elimination of one of the units, or acceptance of a situation in which the place of each is approximately respected. 'The first effect of competition within a concentrate is to eliminate many, perhaps most, of the so-called "independents" – the crowd of smaller unit competitors. They may be eliminated by bankruptcy, or they may be consolidated into a single organization capable of maintaining itself. In either case many small units disappear. Carried to extremes – as was the case in the last half of the nineteenth century – the result was monopoly.'
The NYSE began to require listed corporations to file annual reports, a provision which had been considered earlier. In general, bankers like JP and other businessmen resented attempts by government and bodies like the NYSE to require corporations to provide information about their operations (Sobel, 1965, p178). This was despite the ability of bankers or financiers to require data as part of any request for finance. Public discontent continued, following revelations in cases like the Northern Pacific corner of 1901 (see 3.2). This provided, among other things, ammunition for those who were worried by the increasing power of ‘big business’.

In 1897, a ten-year advance began, ending with the 1907 collapse (Sobel, 1965, p154-156). The UK sets of disclosure rules developed under the Gladstone and Davey Committees were not adopted in USA. Instead, particular States attempted directly to regulate security issues – a method previously rejected by those Committees (Hawkins, 1962, p36). However, other forces were to seek greater disclosure of corporate activities as a barrier against the supposed social and economic evils brought about by the various trusts and combinations.

When Congress established the Industrial Commission (IC) in 1898, one of its concerns was to promote greater corporate publicity (Hawkins, 1962, p69-70; Previts & Merino, 1998, p184-186). In 1900, the re-election of McKinley supported a bull market and saw JP’s reputation grow (Sobel 1965, p160-162). At the same time, the IC recommended two sets of disclosures of corporate affairs (Hawkins, 1962, p70-74).

The first dealt with disclosure standards for newly formed corporations, dealing mainly with industrial prospectus disclosure. Like most who over the years have advocated greater publicity, IC members were not specific on details to be disclosed for safe and intelligent investment. Perhaps in line with UK experiences, full details were to be provided about organization, property and all other material information.

The second set related to established corporations. The aims included proposals to curb the power of big business and to protect the interest of existing stockholders, consumers and employees. Witnesses were asked specific questions about UK Companies Acts. One suggestion was that in USA, advocates of publicity saw it as a means of reforming corporate abuses, whereas in UK, disclosure was to protect investors while encouraging investment in new enterprises. Certainly, the recommendations were based on evidence which suggested that greater publicity of corporate affairs would overcome evils of trusts, combination, speculation, overcapitalization, misrepresentation or concealment by management of material facts from investors and the use of insider information by management at the expense of shareholders.

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116 JP faced pressure as opposing groups bought into Northern Pacific leading to a fierce battle for its control. Some operators sold short and a corner in the market followed. In turn, a slump crippled many other sound securities. JP’s solution was a large new holding company, the Northern Securities Corporation, to settle disputes arising from the corner and to prevent future share market raids on selected railroad properties (Jackson, 1984, p213-214).

117 This argument has been the theme for popular novels, see Ludlum (1985).
The IC's recommendations certainly strengthened the cause of those who sought federal regulation of industrial combinations through publicity. One who advocated such a policy was Theodore Roosevelt. He saw trusts and combinations as an inevitable outgrowth of modern industrial life, being in themselves not injurious to the public. However, abuses of power by corporate managers and promoters needed a remedy. He saw publicity as a first step toward achieving a more effective and broader form of government regulations over business activities (Hawkins, 1962, p90-92).

2.6.2 Accounting interactions
While there was, during the latter part of the century, active public support for company law reform in accounting (Edye, 1979, p225), it tended to be concerned with institutional concerns like registration and circulation of accounts. Guidance on specifics of reporting was minimal. Certainly, disclosure rules were found in various Acts and related case law, but these guidelines still lacked underlying reasoning other than qualitative standards (like 'true and correct') and the establishment of what were to be known as conventions - which were to lead to information tensions. What remained unchanged was the need for secrecy surrounding financial affairs (Previts & Merino, 1998, p117).

Yamey (1979) reviewed the development of accounting conventions in company reporting. He (1979, p234) suggests this occurred within a context of the calculation of profit which was at that time simply an element of the balance sheet (among capital, assets and liabilities). Indeed, he argues that calculation dominated the accounting scene even though the publication of a profit and loss statement would not be made compulsory until the next century. Arguably, the conventions were to meet two requirements:

1. delimit profit to that available as dividends to shareholders, and
2. provide an index for shareholders of the profitability of continuing entities (Yamey, 1979, p239).

The conventions covered both profit and asset issues, with little consideration of liabilities. The liquidity of a company was linked to changes in the net current assets of the firm, so such changes were only included in the profit calculation if realised by actual sales. Similar arguments were used to exclude changes in the value of fixed assets. Another convention was to exclude any unusual, non-current or irregular items from the profit calculation which might distort the index of performance and so misinform shareholders. As regards assets, the reporting of the going concern value of fixed assets and the use of the lower of cost or market value in reporting inventory provided illustrations (Yamey, 1979, p235-236). These conventions would provide those who prepared the reports with wide discretion.

118 Yamey (1979, p231) concluded, 'Much less interest has been shown in the principles, conventions or practices underlying the preparation of accounting statements of profits and financial condition presented to shareholders.'

119 An illustration here was the treatment afforded preliminary formation costs of the company.

120 Management were reported to being not averse to varying the maintenance expenditure and depreciation charges to the income calculation in times of good or bad current earnings (Littleton, 1933, p234).
Discussion was found of issues like the maintenance of capital (Nobes & Parker, 1979, p198) and depreciation, consideration of which had expanded beyond railways to other industries. Matters from the railroad industry were now associated with uniform accounts and regulations issued by particular commissions (Littleton, 1933, p233). As well, in the latter half of the century, attempts were made in some texts on accounting to replace the rote learning of rules with underlying reasoning (Littleton, 1933, p56-61; Previts & Merino, 1998, p154-160). However, a major difference between UK and USA accounting (and the related audit) continued to be that in USA, the extension of credit by bankers was a major influence (Littleton, 1933, p298).

As regards Institutional tensions of a professional type, in 1887 the American Association of Public Accountants was founded (Previts & Merino, 1998, p131-150). Goldberg (1949, Part III) argued that by the end of this period, the accounting profession was well established. The new century would provide many issues for debate.

2.6.3 Reporting of liabilities
The 1900 UK Act would make compulsory the disclosure of the company’s capital structure and a distinction between current and long term debts. While the method used to value the reporting company’s assets had to be specifically described, there was no such reference to how liabilities were to be valued (Edwards, 1986, p124). Indeed, liabilities continued to seem to present few difficulties.

2.7 Summary and Conclusions
In this chapter, it has been shown that during an extended time period, issues from social and economic frameworks have interacted with accounting. A qualification to this study is that particular attention is placed only on developments in the Anglo-American sphere, which included various general-type issues.

As well, by the end of the seventeenth century, the role of a steward and the expansion of commerce had a direct interaction with bookkeeping (Littleton, 1933, p9). While accounting and auditing were well known processes, they were not yet a professional calling in their own right. Double entry bookkeeping had potential as a

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121 Arguably, writings here formed ‘the foundation of the technical literature of professional accounting’ (Littleton, 1933, p236-237).

122 It was reorganised in 1916 and renamed the American Institute of Accountants in 1917. The present name, the American Institute of Certified Public Accountants, was adopted in 1957.

123 Goldberg (1949, Part III), ‘the modern profession of accountancy was established: the ‘accountant’ became a professional practitioner, the study of accounting developed into a diversified but specialist study, the practice of auditing came to demand particular skill and judgment, regular periodic accounting became necessary and raised difficult problems of profit determination, the question of cost determination was discussed, while the accountant in a fiduciary capacity came to control many estates in the interests of creditors or beneficiaries.’
technological breakthrough, helping formulate various issues (like capital or income) in a systematic way:

Argument
2.11 Relationships among individuals and groups required an accounting.
2.12 Relationships among individuals and groups required a governance framework.
2.13 Debates occurred regarding applications of ideas in practice.
2.14 Limited debate occurred regarding the philosophy underlying practice.
2.15 An integral relationship was that with the steward.
2.16 Within manor-type relationships, a narrow scope of stewardship sufficed.
2.17 Stewardship required recording and bookkeeping; reporting; checking and auditing.
2.18 As commerce/mercantilism grew, also did relationships among stakeholders who required a broader scope of stewardship.

During the 17th and early 18th Centuries, there existed non-incorporated bodies and certain companies which were incorporated by charter. The latter included the South Sea Company - the centre of a flood of speculative enterprises in a time of a strong gambling mania (Sykes, 1988, p6). Its collapse left investors with a deep distrust of joint stock companies, leading to the so-called 1720 Bubble Act.

Subsequently, battle was engaged between economic (with necessity of large accumulations of private investment funds) and social issues (the protection of investors). The corporation became an economic necessity. Interactions with accounting followed (Littleton, 1933, p255-257). Large amounts of capital were accumulated which were of a relatively permanent type. This was to be preserved, introducing concepts (like depreciation and renewals) which gave management (now independent) discretion in determining capital and non-capital classifications of expenditures. Capital and income were to be separated, partly as a protection of creditors and partly to determine profits available for dividends declared to shareholders. Again, management were given discretion in determining that profit.

Argument
2.21 Formation of companies was through ‘private’ contracts initially between King or Queen and the proprietors and later between State and the proprietors.
2.22 Formation of companies became more ‘public’ when general incorporation by registration was introduced.
2.23 Investors required strict guidelines as protection from abuse by promoters and management.
2.24 Unlimited liability was used as a governance tool.
2.25 Economic growth and large scale investments were facilitated by joint stock companies incorporated through general registration – subject to quid pro quo publicity provisions – and later with limited liability, providing legal protection of investors which continued to be required.
2.26 Management became independent of owners and a stakeholder in its own right.

At this time, investors were simply those who provided finance – in UK primarily shareholders and in USA primarily bankers. In later chapters, it is argued other parties – employees, consumers and government oversight bodies – also sought publicity from corporate management.
2.27 In a context of a management-stakeholders (mainly shareholders and selected creditors) relationship, the accountants adopted a narrow stewardship role without much reference to a decision-making role.

2.28 A link was forged between managerial control and finance houses.

2.29 Publicity in general and publicity of financial information in particular were seen as governance tools.

2.29a Management sought discretion in reporting.

2.29b The idea was floated that disclosure by honest corporations could be used with minimal prescription as a standard for uniform rules of disclosure.

It was by now beyond dispute that controls (under provisions in statutes)\(^{125}\) were required. Suggestions as to their form came from

- segments of the business world,
- government, and
- the legal profession.

At that stage, the reputations of individual accountants were not yet sufficient for them to be invited to testify as experts\(^{126}\) before Select Committees of Parliament (Hein, 1978, p352; p355-356; Nobes & Parker, 1979, p197). This was despite the importance placed on accounting controls as early as in the 1844 Act.

The perceived non-statutory protection to be afforded shareholders by the development of the profession of public accounting and auditing was still in its infancy, though vestiges of professional organizations of accountants had appeared (Hein, 1978, p144; p352). The accounting profession would later become involved in questions as to whether these controls were to be set up and enforced by the accounting profession or remain within the provisions of the Companies Acts. Debates on the techniques and standards of the accounting profession would eventually lead to a position of importance in business life (Hunt, 1936, p140):

As noted, by the end of the nineteenth century, a boom-crisis/depression-boom cycle was well established in commerce, with accounting and other manipulations and abuses being revealed. The limited liability joint stock company had become a dominant way of doing business. It allowed large amounts of capital to be marshaled, but some worried that a social control was missing, especially as a protection of investors.\(^{127}\) This was to be achieved by publicity and reporting of the affairs of the

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\(^{125}\) In UK tradition, the companies acts framed by Parliament pictured promoters and company officers as stewards of the investors' (both shareholder and creditor) capital. This in turn required publicity of the position of and performance with those assets (Chatfield, 1977, p70).

\(^{126}\) The establishment of accounting professional groups introduced a powerful pressure group which would win control of the prescribed reporting process over lawyers (Littleton, 1933, p265).

\(^{127}\) Hicks (1942, p90-91), 'In order to protect the shareholders against directors who might abuse their position, the law insists on safeguards such as a certain degree of publicity in accounts ... The history of company legislation is a long story of guerrilla warfare between the law and a small fringe of ingenious rascals whose activities form the shady side of company promotion; there is no doubt that in England the law has had the better of the struggle.' However, there is little discussion neither of what is to be published nor with the required standard for quality of that information.
corporation, but management had discretion in that reporting. Importantly, this was also the time of the UK Salomon case regarding the attribute of corporate personality and its implications (Gower, 1957, p63). As well, in both UK and USA, the right of a corporation to hold shares in another corporation was now established.

Arguably, by now the issue had become not one of disclosure per se, but one of how much disclosure and what to disclose (Hawkins, 1962, p26). This led to tensions (in the context of information to be provided in an accounting) between economic and social issues. Certainly, in the period surveyed, issues of a social (especially legal) type held court in UK, though those of an economic type were slowly changing the balance. Those issues and the balance had interactions for accounting in general (of a conventional or a financial type).

**Argument**

2.31 Accounting professional groups were established.
2.32 Conventions found in practice were supported and applied by accountants.
2.42 Conventions were practiced to meet tensions regarding the determination of income.
2.33 The qualitative standard 'full and fair' (today 'true and fair') was not explicitly linked to accounting conventions.
2.34 A boom-crisis-boom cycle was established where questionable reporting practices from corporations led to a scrutiny of accounting methods and practices.
2.35 Stakeholders other than shareholders and management are affected by the actions and reporting by management of corporations.
2.36 The continuity of corporations gave rise to a going-concern valuation of assets.
2.37 A link between crises/financial collapses and a need for reform of accounting reports to provide better quality information was forged.

As regards developments in the reporting of liabilities, various issues were noted.

**Argument**

2.41 A legal bent identified liabilities.
2.42 Liabilities tended to be shown at a legal, nominal amount.
2.43 A distinction was forged between legal and moral obligations.
2.44 New practices like the open-ended mortgage, while not affecting the reporting of liabilities, had implications for the reporting of the amount of that liability.

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128 In USA, however, while the scene was similar in some ways, often subtle differences were to be found. While prior to 1900 financial statements were often seen as a check on the bookkeeper’s work, bankers and other grantors of credit used financial statements to determine eligibility for credit (Hawkins, 1962, p348).

129 The protection of investors had to be balanced with the necessary promotion of legitimate business to increase economic wealth. This was to be achieved by a philosophy of disclosure. It was argued that if the current practices of disclosure by the “best” companies were applied to all, a number of fraudulent promotions which could not stand the light of publicity would be discouraged. Further protection was provided as the investor and related advisors would receive the minimum information needed for informed investment judgments. The investor was free to speculate in any type of new security but fraudulent or inadequately described securities were to be prohibited (Hawkins, 1962, p34-35).
The final point above led to later debate. Other issues and debates continued into the next century, as is shown in the next chapter.

130 Chambers (1973, p30) simply argued that 'the total amount of liabilities is the contractual amount of debts.' This certainly influenced his thinking, as he (p31) continued, 'If the amount of liabilities is correctly stated, the amount of shareholders' equity depends on the total amount of the assets. If the assets are under- or overstated, the shareholders' equity is correspondingly under- or overstated. If the change in the net asset in any year is under- or overstated, the net profit of that year is under- or overstated. It is possible to under- or overstate the amount of liabilities. But the contractual amount of debts owing is one of the more easily determined figures. The adequacy of the balance sheet as a statement of financial position therefore depends a great deal on the values assigned to the assets. For this reason much of the remainder of this book will concern itself with asset values.' Others would see such 'liabilities' as similar to shareholders equity and to be treated in a similar way. This argument is discussed further in Chapter 8.
Chapter 3 The Framework: Corporate Governance in the Twentieth Century

Until World War I – The Dominant USA Influence

Each era is seen largely as the story of the economically dominant nation of the time.... In the twentieth century it is most often the United States.

Chatfield, 1977, piv.

The thesis itself is an historical survey beginning in 1900 of those economic, social and political events, trends, attitudes and practices which culminated in the passage of the 1933 Securities Act. In particular, the study seeks to identify, analyze and interpret - in both the historical and predictive sense - the factors - internal and external to the firm - which led to the need to create minimum standards of corporate financial disclosure through federal legislation.

Hawkins, 1962, pii.

3.1 Introduction

As argued in Chapter 2, during the 19th century, a cycle of prosperity followed by crisis played a major role in the growth of social control of joint stock companies by some sort of regulation - legislative or quasi-legislative. Forces integral to that control would influence corporate accounting practices, setting the foundations for the expansion of the work of accountants. Their particular activities created a class of specialists on reporting and control who in turn organized themselves into what were to become powerful accounting professions.

What Berle (1954, p23-24) termed the 20th Century capitalist revolution changed human life and habits, modified human-type institutions and expanded human horizons. Applications were made of philosophical and scientific discoveries of the 19th Century. In USA especially the capitalist revolution was seen as arguably technical as more efficient and more flexible means were sought through collectivizing capital in corporations. Newly developed methods of production changed the everyday life of most people. Economic and social ideas necessarily developed or were modified to meet the changes.

While arguments as to reporting about corporations and the role of accounting professions were not peculiar to the Anglo-American group, a major thrust for

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131 The latter included requirements of stock exchanges (like listing rules) and, as is introduced in this chapter, the accounting profession (like recommendations, standards).

132 Berle was perhaps before his time when he (1954, p23-24) argued, 'When the whole story is told it will, I believe, be found that the chief impetus to the Communist state as an instrument was the insistence in backward countries that they plunge toward the results of an industrial revolution which was leaving them behind. This, of course, is the precise opposite of the Marxist dogma. Elsewhere the Marxist state seemed a brutal, blunt, and fumbling instrument; capitalism was evolving its own instruments, and accomplishing the twentieth-century revolution with infinitely more humanity and efficiency.'

133 Schmalenbach (1959) provides illustrations of similar issues (for example, the tension between regulation and caveat emptor) in a European context. He (p14) writes, 'The bankruptcy and accounting regulations in the [German] Ordonnance are strongly influenced by the vast number of fraudulent bankruptcies which were a feature of economic and financial life at the time.' This was 1673. In the
reform in those areas in the 20th Century in the Anglo-Saxon sphere appeared in USA. A cycle of prosperity-panic-bankruptcies-lack of confidence was linked to information needed by the investment community (and related possible reforms).124 In this chapter, the argument is presented under distinct headings.

The argument begins with developments from the turn of the century until the beginning of World War I (3.2). Next, the period from World War I until the 1920, is discussed (3.3). The format in the chapter changes to highlight the dominant role of USA ideas which are first discussed, followed by those in UK. Finally, a summary and conclusions are provided (3.4).

3.2 Theodore Roosevelt & the Populist Movement

From 1900 to 1917, a variety of critics were to attack large corporations (Previts & Merino, 1998, p108-110). Arguably during that period, a most important continuing economic and social problem was that of 'big business'. Intermingled were the issues of financial disclosure standards and securities legislation. The attacks were highlighted by several investigations and hearings by the federal government. In USA history, the period was part of the Progressive Era in which people were on a quest for social justice (Hawkins, 1962, p47-50; Previts & Merino, 1998, p175-177).

The re-election of McKinley was well received by business groups, but some, including JP, were less enthusiastic over the choice of Theodore Roosevelt as running partner (Sobel, 1965, p169).135 The assassination of McKinley saw Roosevelt as the new President. JP was ill-advised in his assessment of Roosevelt who, instead of seeking party machine support for a new term, quickly showed concern with developments in financial markets (Jackson, 1984, p218). For his first target he chose the great railroad merger (or Morganization – see 2.6.1) of Northern Securities Corporation.

At the economic level, big business was seen as monopolistic and inefficient. At the social level, it was seen as subverting the USA democratic way of living. Defenders of big business, while not producing compelling rebuttals of social grievances, did respond to the economic arguments. Management argued

\[\text{case of registered companies in Germany/Prussia in 1884, he (p16-17) writes there was 'set off a great speculation in shares, for the gambling instinct of mankind is so strong that any opportunity is eagerly grasped... It is far from the nature of such a speculator to take a look at a balance sheet. But when a heavy stock exchange crash occurs, the band of speculators begins to complain that it was the government's job to protect them from such a catastrophe.'}\]

124 de Bedts (1964, p1) writes, 'Only one thing remains in common in several centuries of legislative efforts to regulate the exploiter of the investor. Inevitably such attempts come about only when the disastrous results are seen in retrospect. Calamity must befall those who have ventured their funds before protective measures may be launched.'

135 As mentioned in Chapter 2, his slum-clearance program and attacks on sweatshop employers while involved in local government in New York were seen as non-Republican policies. Some argued his move to the office of vice-president would see his political emasculation (Jackson, 1984, p203).

136 Jackson (1984, p219) suggests JP took Roosevelt's 'radicalism' far too lightly, arguing perhaps JP's 'bullish euphoria led him to see himself as a one-man super state, free from moral, legal, and political restraints, ruling lesser men by Divine Right.'
• their corporations were a series of private relationships beyond governmental regulation,
• philanthropy had no place in their role in business, and
• publication of financial information was unnecessary.

However, critics could point to the findings of various investigations which supported their claims (Hawkins, 1962, p54-66; Sobel, 1965, p178).

Within that environment, it was announced in 1902 that under the Sherman Antitrust Act, the Northern Securities was to be dissolved as a monopoly and an illegal restraint of trade (Sobel, 1965, p170). At the same time, serious damage to the economy threatened from strikes by workers (especially miners) with whom management refused to meet and a stock market depressed by a glut of unsold securities. Several banks, both rural and metropolitan, were under strain from a shortage of liquid cash. Continuing strikes would not only cause hardship and cripple transport but also could lead to nationwide disruption (Jackson, 1984, p231). With JP’s endorsement, owner-management finally accepted arbitration through a presidential commission.

However, JP concentrated on his self-imposed crusade to rescue Big Business from Theodore Roosevelt, about whom JP had become almost paranoid (Jackson, 1984, p237). Arguably, while Roosevelt’s showmanship was underpinned by a sure instinct for public opinion, JP remained quite out of touch with changing social trends (Jackson, 1984, p238). Somewhat surprisingly, JP’s firm did work with the President as fiscal agent in the takeover of the Panama Canal Zone. With the dissolution of Northern Securities supported by the Supreme Court, the Roosevelt administration established a Bureau of Corporations (1903-1914) to investigate interstate trusts (Hawkins, 1962, p52, p90; Jackson, 1984, p240). Having been elected President in his own right by an overwhelming majority in 1904, Roosevelt embarked upon an aggressive antitrust drive.

Roosevelt increasingly used the Bureau’s investigatory powers to supplement antitrust prosecutions of the Justice Department. Lacking control of the Republican Party’s

137 JP reportedly ‘angrily denounced Roosevelt for not giving him the opportunity to work out some compromise before charging in with this public challenge’ (Jackson, 1984, p220-221). His contempt for antitrust announcements from Washington would continue, as would worker strikes, swindles involving the trust concept (for example, United States Shipbuilding Company) and management/owner refusal to acknowledge the unions.

138 Gross (1966, p61) points out that the 'president was the nation's chief opponent of industrial consolidation, while the banker [JP] was its greatest practitioner.'

139 Rocco (2003, p198-203) refers to Roosevelt’s role in the building and takeover of the Panama Canal as part of his struggle for USA naval and commercial interests.

140 However, it was cynically argued that the Bureau ‘had remained so inert that Pulitzer's New York World echoed a widespread suspicion that the cartel barons had bought themselves protection ...’ (Jackson, 1984, p240). Ripley (1926, p226) refers to the powers of the Bureau which preceded those of the Federal Trade Commission (which in 1914 absorbed the Bureau).

141 Antitrust actions continued during the period against various companies, including American Tobacco, Du Pont and Standard Oil. Standard’s dissolution as a holding company was upheld by the Supreme Court but the decision was subject to "undue" restraint of trade. This was a most elastic loophole for the defence lawyers. The trust was dissolved by being broken into over thirty separate
conservative wing, he acted instead in antitrust areas where he did not need congressional collaboration. He also used widespread popular support when his legislative recommendations faced opposition in Congress (Hawkins, 1962, p93). However, an arguably more effective form of CG - full disclosure of corporate affairs, both financial and non-financial - was still some decades away.

Awareness of social abuses was reflected in political action (Sobel, 1965, p188). A Legislative Investigating Committee (LIC) in 1905 focused on the affairs of the three largest insurance companies (Equitable, Mutual and New York Life). It was alleged that the companies had improperly used their funds to finance overcapitalized promotions, including those of JP’s firm. The insurance corporate management had tempted long-term investors with high-interest yields, using an advantage they had over the national banks who, being subject to federal laws, had to maintain at least 25 percent of their deposits in cash. Benefiting from purportedly very slack auditing, the bulk of their assets went into speculative trusts and inflated bonds. Not only was the primary control - transparent financial reporting - found wanting, but the related control - auditing - was also questioned. Arguably, the findings of LIC inflicted far more damage on the trusts than the dissolution of Northern Securities (Jackson, 1984, p256).

The resulting LIC report disclosed large sums had been expended in a surreptitious manner by Equitable Life in particular. Legal expenses included contributions to political parties at both national and state levels, and for the services of highly paid Washington lobbyists. These revelations shocked the public (Jackson, 1984, p257).142

JP thought the insurance probe unlikely to have the damaging results that some fellow bankers feared. Indeed, LIC’s very critical findings fizzled into the dismissal of a selected few corrupt officers with little change of loose investment procedures. No large-scale purge materialized, but policyholders were at least assured that company assets would be more closely supervised in future. Arguably, it did not scare off questionable operators (Jackson, 1984, p257-258). Attacks continued on large corporate combinations including Standard Oil (Gross, 1996, p54-56), but with little effect.

JP was able to dismiss rumours of

- a Wall Street slump,
- lack of support for various floats in both private and public sectors,
- receiverships in the railroad industry,

companies. But it was a Clayton’s dissolution. The Rockefellers continued to own 25 percent of the shares in each company and still directed policy (Sobel, 1965, p199; Jackson, 1984, p283; Gross, 1996, p56). This was ‘enterprise’ action at its extreme. When, during the Taft administration, US Steel and its subsidiaries were indicted as ‘unlawful monopolies’, JP was aghast with the treacherous actions of yet another Republican president. However, the suit met a legal impasse and lost significance during the coming wartime boom in steel production. Almost a decade hence, a Supreme Court majority decided the trust represented a concentration of efforts with resultant economies and benefits rather than a monopoly (Jackson, 1984, p298-299).

142 While public outrage may have been growing, little was achieved in CG. One could be forgiven for comparing the events then with the euphoria preceding the DotCom crash some hundred years later.
• what was then a substantial fine on Standard Oil of $29 million (Sobel, 1965, p188; Gross, 1996, p62),
• potential charges of the Morgan-controlled International Harvester being a monopoly, and
• troubles with rural banks (Jackson, 1984, p263).

He could not, however, dismiss the Knickerbocker Trust-led crisis (Sobel, 1968, p297-321).

In that collapse, large reserves from stockholders and savings accounts of depositors were dissipated. Much of the investors' cash was tied up in long term loans and dealings with unscrupulous operators who, amongst other things, were trying to corner the market in shares in United Copper Company (Sobel, 1965, p191-193; Gross, 1996, p62). Other trusts and banks were quickly under threat. 

During the crisis, JP established a salvage fund run by a private sector syndicate which sought potential federal support (Jackson, 1984, p266). To receive funds from the syndicate, an applicant had to convince members of earnings potential and a satisfactory management structure. To prevent a national banking crisis, JP's plan required presidential support. As US Steel was to buy Tennessee Coal and Iron (TC&I), a potential monopoly case might be brought against the Morgan interests. Roosevelt finally agreed and the market revived (Sobel, 1965, p193-196; Jackson, 1984, p271; Gross, 1996, p63-72).

Gross (1996, p60) argues that JP's actions helped convince the financial world of the critical need for a central Federal Reserve System. Its introduction would arguably provide stability in the banking system and financial markets. Gross (p73-74) bases his conclusion on legislation (the Aldrich-Vreeland Currency Act) passed in 1908 to control money supply and to create a National Monetary Commission (Sobel, 1965,

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143 Sobel, (1965, p271-272) contrasts this panic with earlier and later ones, "The market developed weaknesses on Friday, October 18 [1929]. U.S. Steel, General Electric, Westinghouse, and other stock leaders lost more than five points each. There had been worse days in the past, and the financial writers and the Wall Street crowd never worried about a major crash. The 1873, 1893, and 1907 crises could not recur, they said, because of strong leadership on the Street, enlightened Federal Reserve policies, the strong economic structure of the nation, and the ability to profit from lessons learned in the past. In any case, everyone knew that the great crashes were always signaled by a warning of one kind or another. In 1873 it had been the failure of Jay Cooke; several large railroads, including the Reading, had gone into receivership prior to the 1893 crash, and in 1907, the Knickerbocker Trust collapse was the panic signal. The skies seemed clear on October 18, 1929. A businessman's Administration was in Washington, the banks appeared sound, and there were no warnings of danger. Despite all this, the mid-afternoon decline of that day marked the beginning of the worst crash in American history."

144 Gross (1996, p63) argues that the situation resulted in part from a lack of an agency, either corporate or government, to provide a set of safeguards for the financial markets. Since the 1830s when Andrew Jackson (recall 2.4.1) closed the Bank of the United States, the country had lacked a central bank to regulate the money supply and oversee the banks' affairs. During periodic bank crises, especially in 1873 and the 1890s, there had been calls for greater federal involvement. However, when the banks and other financial institutions inevitably recovered, criticism slowed.

145 Any reprieve would prove temporary as the securities market was toppling, especially in railroads and steel. As well, New York lacked the cash to pay its schoolteachers and other employees' salaries or to meet general obligations (Jackson, 1984, p270-271; Gross, 1996, p69-70).
However, given that legislation sought by Roosevelt was refused enactment by Congress for some seven years,146 others were more cautious in crediting JP with such lofty aspirations.

Jackson (1984, p275) is much more suspect of JP’s ruthless exercise of centralized financial control. It did little to improve national production or tackle the basic causes of a depressed economy. Indeed, the forced sale of TC&I stock for around $50 million ultimately enriched the steel trust tenfold (Sobel, 1965, p196). This was of no comfort for investors ruined by the failure of Knickerbocker. Unemployment soared to over three million, with most soon desperate enough to work for thirty-five cents a day. Social evils of an alarming crime rate in the cities and thousands of so-called vagrants being rounded up by the police in rural areas followed. The euphoria of the potential of the stock market continued unaffected, the public relieved that the crisis had apparently ended with far less damage than many feared (Sobel, 1965, p197-198).

Criticism of the President from some quarters led to his urging a moral regeneration of the business world. This was interpreted as a warning to Standard Oil, the tobacco trust, and other prime targets (Hawkins, 1962, p52-53). The latest crisis had starkly exposed the limitations of his antimonopoly measures but it had nevertheless proved that only banking decentralization, with stricter and far more responsible federal control, offered any hope of lasting stability (Jackson, 1984, p277). While Roosevelt was considered by some as a foe of big business, he was conservative in his economic views. His argument was with bad, not all, trusts (Sobel, 1965, p199).

JP disregarded various signals of discontent, concluding instead that his will could be imposed not only on the most powerful banks and trusts, but also if necessary on the federal government. His next logical step was to bring under his control the asset-rich life insurance corporations. One easy prey was the weakened Trust Company of America (Jackson, 1984, p277). Others too would come under his control (Sobel, 1965, p200).

The financial panic of 1907 revealed inter alia, the inadequacy of publicly available information on the corporations as well as outright fraud in industrial and insurance industries. Big business was discredited in the eyes of many, providing a social environment favourable towards increased demand for remedial legislation. Government undoubtedly began to assert more influence to control corporations by regulation, creating in turn new and large demands for accounting services.147

When in 1908 Roosevelt stepped down, JP’s well-tried strategy seemed unchallengeable, with substantial control of New York’s two most flourishing banks, three trusts and the leading insurance companies. As well, control had been achieved

146 Congress would finally enact legislation to create the Federal Reserve Board in 1913 and the Federal Trade Commission (FTC) in 1914. Edwards (1960, p154) points out, ‘While the United States was vacillating between neutrality and participation in World War I, a new arm of the government was created, the Federal Trade Commission. One of its functions of interest to accountants was to investigate all corporations in interstate commerce except banks and common carriers and require financial reports from them.’

147 This arguably also saw the beginning of the market for professional advice concerning possible loopholes and other ways by which legislation could be circumvented.
in respect of capital infrastructure of 50,000 miles of railroads and near-monopolies like United States Steel, General Electric, International Harvester, and the American Telephone Company. The only two serious threats would come from either a hostile administration or arguably JP's own folie de grandeur (Jackson, 1984, p282-283).

Monetary trust investigations began in 1909 when a New York state committee (the Hughes Committee) investigated the affairs of banks and insurance companies and the practices of the NYSE. Filings of financial statements of listed companies with the NYSE were recommended. Another finding indirectly approved the market-place as a self-regulatory device (Sobel, 1965, p195). As a consequence, it was argued, legislation to control the NYSE was unnecessary.

Before an investigating committee on the Steel Trust, Judge Gary (JP's key lobbyist148) agreed 'that some cooperation might be possible under stricter federal supervision, but reminded them that an efficiently run trust was infinitely preferable to the wildcat speculation of the bad old days.' He argued qualities like JP's149 might do harm or good in banking circles.150 A balance towards good was implied. Nothing was resolved by the committee (Jackson, 1984, p283-284).

Industrial relations problems and additions by merger to JP's railroad network continued to provide adverse publicity. It could be claimed JP now virtually controlled USA cash and credit systems. If necessary, he had direct presidential contact with the lethargic and often unpredictable Taft administration (Jackson, 1984, p291, p294).

After an initial focus on giant corporations and their industrial combinations, the progressives' attack, sometime after 1910 and especially after the 1912-1913 Money Trust Investigation, moved to the Money Trust (including JP and fellow investment bankers) which, through its control of big business, allegedly ran the country (Hawkins, 1962, p50-51; Sobel, 1965, p199).

In the meantime, events were again to have unexpected social and economic effects. Roosevelt ran again for president under the Progressive Party, part of whose platform included liberal reforms. JP gave the Democratic nominee, Woodrow Wilson, no possible chance of victory. He was seen as a woolly, high-minded idealist (Jackson, 1984, p299).151

148 Jackson (1984, p284) observed, 'Morgan had good cause to appreciate Gary's value as a lobbyist, past and present. He observed after a board meeting at 23 Wall Street, "I don't know what I'd do without him. The Judge can have anything within my power to give."' See also Sobel (1965, p196); Previts & Merino (1998, p222).

149 Here, wealth, character and courage were explicitly mentioned.

150 Gary argued for application to the individual, the corporation or Government.

151 Wilson, born in Staunton, Virginia, was elected president in 1912. In that year, the USA Senate convened the Clapp Committee (1912) to investigate 'Big Business contributions to Republican campaign funds from the 1904 presidential election onward.' As well, other investigations followed (Jackson, 1984, p302-303).
Wilson (1913) argued that the greatest monopoly in USA was the money monopoly. While an industrial nation was controlled by its credit, the USA system of credit was concentrated in the hands of a few men who had the ability to check or destroy economic freedom (Jackson, 1984, p300). Wilson's argument was taken up by Brandeis (1913, p1-6).

Brandeis claimed the dominant role of the investment banker in the creation of big business had seen them directing power in a number of large railway, public utility and other industrial corporations. They had similar power in certain banks and trust companies, giving them control over and use of 'other people's money'. Brandeis argued that in order to destroy the financial monopoly found in big business, the money trust had first to be dissolved.

The House Committee on Banking and Currency in 1912 included a sub-committee (popularly known as the Pujo Committee) to which various business interests (including JP) were called to testify. It was to investigate the events leading up to the 1907 crisis, especially the remarkable 'community of interest' subsequently developed between JP's firm and the country's most influential banks, trusts, and insurance concerns. 'With the president-elect's approval the committee would determine whether this constituted a "Money Trust" that had allegedly ignored the national interest for selfish motives of gain' (Jackson, 1984, p304).

Despite probing questioning, JP in evidence referred to phrases like 'the thing to do' and 'it would be better'. JP argued that training and heritage, when based on trust and honour, meant people like him were best equipped to run the nation's financial affairs (Allen, 1948; Sobel, 1965, p199; Jackson, 1984). Interestingly, as is discussed later, the idea that training and heritage produced people who could and would exercise necessary control based on trust was raised again in debates on the control of

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152 Similar charges were made in other countries, including UK and Germany (Sobel, 1968, p324).

153 The Wilson-Brandeis argument is also discussed in Hawkins (1962, p51-52).

154 Parallels may be drawn with the 1990s when Enron's questionable financial actions in which a congruence of interests among financial institutions is required to facilitate those actions. They would later be subject to Congressional inquiry and public outrage (The Economist, 2005d, p7). Jackson (1984, p305) continues, The country was agog for [JP's] appearance as a witness. It had an added piquancy. Samuel Untermyer, chief counsel for the Committee, had made his reputation as a relentless prosecutor in exposing the Equitable Life Assurance Company's irregularities, the Standard Oil monopoly, and several other suits for violation of antitrust laws. As a lifelong champion of organized labor and his fellow Jews, he was expected to strip the proud old bigot of all his epaulets and decorations in what promised to be a Dreyfus trial in reverse. As it turned out, there was no vulgar attempt at character assassination, Untermyer's courtesy fully matching the dignity of his opponent. To continue the modern analogy, Warren Buffett's appearance before regulatory authorities in 2005 to respond to concerns about untoward 'insurance' practices held great public attention (Aylmer, 2005; Cootan, 2005; Drawbaugh, 2005).

155 One exchange may be used to support JP's type of argument. There, Untermyer, chief counsel for the Committee, suggested to JP

"that profit was the mainspring of his system."

"No, sir" Morgan objected emphatically. "The first thing is character."

[Untermeyer asked] "Before money or property?"

the securities market and the related development of accounting principles (see 3.2.2 & 4.4.2).

The resulting Pujo Report clearly endorsed Wilson's new Federal Reserve system and his repeated pledge to check monopolistic stock holdings (Jackson, 1984, p310). It would also lead to the Clayton Act introduced to monitor monopolies and arbitrary price fixing. It became illegal for anyone to serve on the boards of two competing companies or on more than one bank whose capital reserves and undivided profits exceeded $5 million (Jackson, 1984, p314). As well, various stock exchanges were seen, by their listing requirements, as a way of achieving more uniform and complete corporate publicity — a key part of corporate reform (Hawkins, 1962, p97-99).

While the Pujo Committee did not prove the claim of complete corruption in the stock exchanges, the actions of the exchanges were certainly not seen as being virtuous. Arguably, NYSE supported greater publicity of corporate affairs. However, in 1913 more concern was placed on immediate problems like effective control over members or increasing the number of listed companies (Hawkins, 1962, p102-103).

JP's death in 1913 to Jackson (1984, p312) 'toll[ed] the end of an era. His firm would grow far richer in the WWI and during the seven fat years before the Wall Street crash, but no private banker would ever again govern America's cash and credit as, for good or ill, he had for over a quarter of a century.'

From 1908 to 1914, business and finance in general and Wall Street in particular were under scrutiny from various government bodies (Sobel, 1965, p198; Sobel, 1968, p324-327). In one investigation, the NYSE was described as a 'private club' to which legal methods to control fraud and other irregularities by members were not enforced. Members' interests were dominant.

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156 de Bedts (1964, p5) reinforces the situation, 'The Pujo Committee's recommendations, which included outlawing stock manipulation, separating the banking and investment functions, and preventing officers from borrowing their own bank's funds, found little response in Congress. The emergency efforts of the Federal Trade Commission during World War I in the securities field proved entirely ineffective but furnished the basis for some legislation that attempted correction of fraudulent security issuance.'

157 Members of the investment banking community in general supported a demand for greater publicity of corporate affairs (Hawkins, 1962, p107).

158 Gross (1996, p64) concluded, 'At root, he was a relentless seeker of order; a banker, not a speculator.' See also Sobel (1968, p322-323).

159 de Bedts (1964, p15) writes, 'The Stock Exchange, as reflected in ... addresses, statements, and Congressional testimony, was a completely laissez-faire institution, the impersonal operations of which were aseptically referred to as a barometer that simply recorded national business and industrial pressures. Any reference to activities of its members in pursuit of personal gain at the violent expense of the public economic good was effectively forestalled. This was accomplished by a refusal to consider that the mechanics of Exchange operations or the practitioners thereof were of public interest or subject to public criticism. As SEC commissioner William O. Douglas described it several years later, the image presented was one of a private club in which the members could do no wrong, so long as their behavior toward each other was governed by club rules.'
As did JP in particular and business in general, the accounting profession (represented by the American Institute of Accountants) objected to the proposals for federal government intervention (Previts & Merino, 1998, p186-187). Its committee to deal with federal legislation included G O May, senior partner of Price Waterhouse (Hunt, 1936, pv-vi; Chatov, 1975, p49-50), who later assumed a role of consultant/advisor/link between the profession and other bodies like the NYSE. He was instrumental in the development of conventional accounting, becoming a key spokesperson for the practitioner wing of the profession. He proposed the universal adoption of the disclosure standards as set forth in UK Companies Acts as members of the AIA would be able to render a higher service to the community. However, he did not want this through legislation but through cooperation with bodies like the NYSE or Investment Bankers Association of America (IBAA).  

While discussion in this section mainly deals with federal issues, at the same time there were attempts to reform at the state level. Some states in their public service laws began to consider regulation to protect investors as well as consumers. Use was made of mainly financial reports, some to state authorities (considered confidential) and some to stockholders. However, any protection in the form of financial disclosure to stockholders was minimal (Hawkins, 1962, p133-134).  

Also sought was protection of citizens from fraudulent and unsound investments. In 1911, the state of Kansas passed the first comprehensive licensing statute related to corporate securities. The Kansas Bank Commissioner was authorized to prohibit the sale of any security in Kansas unless, in his opinion, the corporation issuing the security promised a fair return and management was honest, fair and just. These state statutes were called blue sky laws and were based on a paternalistic regulation philosophy rather than, as described in Chapter 2, the disclosure philosophy of the UK Companies Acts (Hawkins, 1962, p128).  

A minimum aim of these blue sky laws was to protect the purchaser of securities from fraudulent promoters. Some went further and sought to protect investors from unwise investments, even though the transaction was honest. Companies were required to file semi-annual reports and keep certain books and accounts. The latter were subject to examination by a bank commissioner as often investors knew little of either the business instruments like bonds and stocks or the enterprise in which they were asked to invest. In line with the populist political thinking in Kansas, the state was expected  

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160 His major contributions are further analyzed in Chapter 4.  

161 Hawkins (1962, p138-139) provides an interesting analysis of a study by Horack (1903, p79-122) on these financial reports. Walker (1978, p8-18) provides an excellent summary of early attempts (from 1890s to 1907) to develop a general framework for asset valuation and related consequences which would remain the case until the 1940s.  

162 Subsequently, other states enacted similar laws and by 1933 every state except Nevada had passed a general statute to regulate issue and sale of securities to the public (Hawkins, 1962, p128).  

163 This was prompted by the unprecedented prosperity experienced in the agrarian states like Kansas. Unscrupulous promoters were able to convince the citizens to exchange their savings for stock in mining, oil, land and loan companies which often proved to be fraudulent or financially unsound.
to protect citizens from securities hawkers and fraud-artists (Hawkins, 1962, p139-147).

This period saw changes in social conditions that produced a popular distrust of great wealth or great economic power, much to the dismay of those such as JP (Allen, 1948; Jackson, 1984). Public awareness of the transgressions of big business and of the influence of money on political life increased. A new breed of politicians (of which Teddy Roosevelt was typical) also used public indignation to achieve administrative and legislative change.

3.2.1 The UK scene
Around the turn of the century, a boom occurred in mergers and amalgamations (Walker, 1978, p23; Green & Moss, 1982, p14), trusts being prevalent as in USA. Included therein were the activities in the RMSP group (see 4.2.1) and the London and Globe Finance Corporation (L&GF). The latter was a corporate colossus with activities in several countries and used ‘group’ arrangements. Its collapse and related criminal trial of Whittaker Wright\textsuperscript{164} revealed profit manipulation via asset write-up and inter-company transactions (especially share trading) to manufacture artificial profits and improve balance sheets as well as questionable cash transfers. ‘Window-dressing’ of balance sheets had become, within limits, common practice in the City (Vallance, 1955, p56-58, p64; Walker, 1978, p35).

The crash of L&GF came so suddenly that it shook the City.\textsuperscript{165} Techniques used allowed individual companies to continue to ‘report’ profits, then go out and borrow. However, the Ponzi scheme,\textsuperscript{166} as would others over ensuing decades, eventually imploded.

The commercial and social moralities of the day were questionable given the ability of the directors to obtain a process of voluntary liquidation, ensuring no official probe of the books of L&GF. As well, one of the liquidators appointed by the Court was a senior partner in the firm which had carried out the audit. Later, in an official investigation following an Order for compulsory liquidation, irregularities were found in the accounts. Many investors and stockbrokers defaulted and consternation followed the announcement that the Crown would not be prosecuting as at that time under Company Law, it was not an offence to issue a false balance sheet. Further, a

\textsuperscript{164} His financial activities in Australia are well chronicled in Sykes (1988, p215-223).

\textsuperscript{165} Haldane (1970, p91-92) relates: ‘On 15th December 1900, London & Globe published its accounts; these showed it to be prosperous and there was no hint of the shock so near at hand. Thirteen days later the Company was declared insolvent and went into liquidation; and this in turn precipitated the collapse of the others. At the winding-up proceedings it became apparent to the Official Receiver that the books were wrong. Whereas London & Globe’s records showed a profit for 1899 of L463,372; in fact there was a deficit of no less than L1,600,000. The question naturally arose: how long had this pretence been maintained and how had it been done? And what about the others? The answer is that the accounts had been adjusted, so that as one company got into difficulties, it was held up by a loan from one of the others, enabling the payment of dividends to be maintained.’

\textsuperscript{166} Clarke et al (2003, p70). ‘A “ponzi” scheme was named after a 1920s US market operator, Charles Ponzi. Such schemes promised high returns on risky assets and their success depended on maintaining investors’ belief that assets’ prices would continue to rise forever.’ The technique would be applied to various settings over the remainder of the century and persist into the next.
criminal prosecution for fraud was unlikely to succeed unless personal benefit to the falsifier was proven. Later, a stockbroker named Flower approached Mr Justice Buckley (later Lord Wrenbury) who agreed that a prosecution could be brought under the Larceny Act, 1861 (Vallance, 1955, p62-63; Haldane, 1970, p93).\textsuperscript{167}

In 1900, the compulsory audit control (abandoned in 1856) was reintroduced for the ordinary business company (Hein, 1978, p137; Aranya, 1979, p266) and under the 1907 Act to publish a balance sheet was again required (Haldane, 1970, p12; Hein, 1978, p77; p138; p192; Nobes & Parker, 1979, p198). However, much latitude was still given to preparers of balance sheets as to what was to be published (Edey, 1979, p226).\textsuperscript{168}

The 1908 Act was preceded by the Warmington Committee of Inquiry (1906). Arguments were again posed concerning more detailed disclosure, including the compulsory publication of profit and loss data. A professional accounting body (there were at least four other UK bodies) made submissions. These included the proposed publication of details from the trading account. This was a new idea as preceding profit and loss recommendations started with the gross profit line of the trading account (Hein, 1978, p260; p352-353). However, the policy of minimum disclosure continued, the reasoning being that those who dealt with limited liability companies were required to make their own inquiries (Aranya, 1979, p268).

Under the Companies (Consolidation) Act, 1908, a balance sheet was to be filed with the Registrar. This was to contain a summary of the liabilities, giving particulars such as to disclose their general nature (Hein, 1978, p233).

While Vallance (1955, p80) suggests no notable schemes to defraud a gullible public were discovered in the decade before WWI, a less notable situation related to the Charing Cross Bank. The leading figure here offered depositors a most generous interest rate. In turn, after some unsuccessful speculations in gold mines and patents, the funds were invested in land development in Canada. Eventually, the deposit interest was paid not from funds from operations but from fresh deposits.

Suspecting employee embezzlement, a reputable accountant was approached to investigate the bank’s affairs. Satisfied with the findings, the firm of accountants was later engaged to audit and advise on the accounts of the bank. This time, however, the accountant questioned the profitability and liquidity of the bank, concluding it to be morally wrong to accept further deposits. When the bank officers failed to follow that advice, the accountant reported the situation to the Director of Public Prosecutions. An official investigation found that asset values were at best doubtful and that the books had been falsified for years (Vallance, 1955, p81-83). The cycle continued.

\textsuperscript{167}This would also be the mechanism used in the aftermath of RMSP’s collapse two decades later.

\textsuperscript{168}For instance, Green & Moss (1982, p25-26) write of the ability of management, in preparing the RMSP accounts for 1905 to 1907, to change depreciation rates and create reserve funds from profits in order to reduce the apparent costs of ships and to appear conservative. As well, less detail appeared in the accounts, it being claimed to be necessary to deny competitors useful information.
3.2.2 Accounting interactions

At the Institutional tensions level, as might be expected, practitioners and their professional bodies played a vital role in matters related to the financial reports (Previts & Merino, 1998, p187-188). Submissions were made in UK to various Committees of Inquiry concerning Company Law issues. Early issues of The Journal of Accountancy (established in 1905 by the AIA) included reports of a Special Committee on Accounting Terminology (established in 1909).

Information tensions also grew. Some sought a more academic approach in discussing accounting practice and its underlying reasoning. Two authors, Sprague (1907) and Dickinson (1913), provide insights of those times into issues in general and of liabilities in particular.

Sprague’s The Philosophy of Accounts presented a rationale of ideas underlying the preparation of accounts. Those faced with the task of preparing accounts would understand why they prepare accounts in a particular way. Sprague had been involved in technical matters and underlying reasoning for some years (Littleton, 1933, p203; Paton, 1972, piv; Previts & Merino, 1998, p154-156).

Sprague (p3) restricted the term ‘account’ to that which deals with financial facts, although the definition adopted is broad enough to include not only those items found in a ledger but also the balance sheet itself. He (p5-6) also introduced a notion of reciprocity in the related accounts of distinct entities (A and B). Implicitly, reasoning underlying both the identification and measurement of assets and liabilities is introduced.

Sprague (p20) envisages the balance sheet as an ‘account’ of some thing or event. Building on his considered importance of the balance sheet, the balance sheet (p30)

...must comprise:

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169 Other writers, for example Hatfield (1909), were of course active in the area. In this study, Sprague’s work is selected to represent the ‘academic’ approach and that of Dickinson as one with the more practitioner orientation.

170 Paton (1972, piv) summarizes the resolution of the dilemma some faced: ‘Sprague brushed aside the tiresome, muddled, fanciful rules-of-thumb that had cluttered the texts on bookkeeping for many generations, and presented the framework of accounting procedure logically in terms of the basic financial components and concepts of the business entity, with respect to measurement of both position and performance. He ignored the weird practice of personifying accounts ... He likewise abandoned the prevailing absurd methods of account classification ... Above all, he pushed the door ajar to a realization that accounting constitutes the outstanding approach to a pervasive understanding of business enterprise, with its complex array of transactions and operations, and the continuing need – throughout – for financial measuring, reporting, and planning.’

171 Sprague (1907, pix) elaborates, ‘As a branch of mathematical and classificatory science, the principles of accountancy may be determined by a priori reasoning, and do not depend upon the customs and traditions which surround the art. I have endeavored to set forth these principles simply and naturally without resorting to fictitious modes of presentation, but adhering to the fundamental equations and their subequations.’ Some decades later, Chambers (1966a, Chapter 6) would echo similar thoughts.

172 The idea is applied to a relationship of an entity (A) with a bank (B) where A’s account with B and B’s account with A are reconciled.
(1) the values of assets, consisting of property and claims, to which the person, or collection of persons, has title;
(2) the values of the claims existing against the assets and which must be satisfied from them; and
(3) the value of the residue after subtracting (2) from (1) and the respective proprietary interests in that value.¹⁷³

He (p34-37) later would apply reciprocity to what a balance sheet would represent. Under one mode, it was 'The Universe in Account with [the Proprietors] and under another, '[the Proprietors] in Account with the Universe'.¹⁷⁴

While it is apparent that the values of the three elements¹⁷⁵ comprise the balance sheet, a dilemma rises. Since the concept of 'asset', defined in (1), is used in the explanation of (2), it might be inferred that unless there are assets, there can be no 'liabilities' or 'claims'.

The dilemma may be resolved if one notes that Sprague (p31), with shades of Pacioli, states that one of the two ways of constructing a balance sheet is '(a) By actual investigation of quantities and prices of assets, and of liabilities; also of distribution of proprietorship. In inaugurating a system of accountancy for a concern which has had no suitable accounts this is the only way. It may be called the inventory method.'

If liabilities exist only if there are assets, then without assets the extent of liabilities per se might not be investigated. The quantities and amounts of assets must first be established to which reference must be continually made while determining liabilities. Sprague's writings on liabilities would not seem to suggest that interpretation. His concern is with the reasoning underlying a process of preparation of accounts. Further support is provided by the analysis summarized in Figure 3.1 of his phases (or stages of development) of the parts of the balance sheet.¹⁷⁶

Sprague's phases fall into two distinct categories. In one group are found rows 1, 3, 6 and 7 for Property, Assets, Capital and Cash etc respectively. Here, the sine qua non characteristic is found in the column headed assets, both liabilities and proprietorship being defined in terms of this characteristic.

It might be argued that it is equally possible that proprietorship is the all important heading with assets and liabilities being defined in terms of this characteristic. However, two reasons support that asset is the primary heading. First, Sprague shows assets as the first heading. Second, he tends to have on occasion a single term under

¹⁷³ Paton (1972, pvi) notes that Sprague 'was a bit of a reformer in English spelling, but his use of "positiv" and "negativ" ... scarcely warrants high praise.' Similar 'spellings' appear in quotations used in this chapter.

¹⁷⁴ The former was to Sprague the USA mode and the latter the UK mode.

¹⁷⁵ Sprague (p37) warns of the use of the term 'capital' by bookkeepers to refer to the proprietors' element. He points out the distinctive terminology concerning 'capital' found in economics. Chambers (1966a, p114 & 124) would also make the distinction.

¹⁷⁶ This is a penetrating analysis regarding a definition of liability in accounting. It certainly provides a basic standard against which other writings may be evaluated.
assets, qualifying terms being added in the other two columns. It might be inferred that asset is the key category before further reasoning is possible.

The second group comprises rows 2, 4, 5 and 8 for rights against others, services heretofore given, services expected to be received and debtors to the business respectively. Here, as in the first group, all three parts of the balance sheet are defined in terms which have common characteristics; but two parts are not based on the term used in the remaining part. For example, in row 2, the parts are defined in terms of relationships of the concern with other parties. This is consistent with Sprague's statement (p49) about liabilities, 'As rights, they are the rights of others against us and our property, just as the assets are our right against others."

While in the first group it is impossible to have as a liability a source from which cash has been received (without assets in cash or cash equivalent) nor as a liability a deduction from property (yet no asset property), in the second group another possibility is found. Arguably, while there is no asset (rights against others), there may be a liability (obligation to others) and therefore a deficit of rights rather than a surplus in proprietorship. Similarly in rows 4 and 5 all parts are defined in terms of services and in row 8 in terms of a relationship with the business.

**Figure 3.1 Analyses of the phases of the parts of the Balance Sheet**

<table>
<thead>
<tr>
<th>ROW</th>
<th>ASSETS</th>
<th>LIABILITIES</th>
<th>PROPRIETORSHIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Property</td>
<td>Deductions from property</td>
<td>Net property</td>
</tr>
<tr>
<td>2</td>
<td>Rights against others</td>
<td>Obligations to others</td>
<td>Surplus of rights</td>
</tr>
<tr>
<td>3</td>
<td>Assets</td>
<td>Negative assets</td>
<td>Net assets</td>
</tr>
<tr>
<td>4</td>
<td>Services heretofore given</td>
<td>Services heretofore received</td>
<td>Surplus of services rendered</td>
</tr>
<tr>
<td>5</td>
<td>Services expected to be received</td>
<td>Services which must be given</td>
<td>Surplus of services receivable</td>
</tr>
<tr>
<td>6</td>
<td>Capital</td>
<td>Loan – capital</td>
<td>Own capital</td>
</tr>
<tr>
<td>7</td>
<td>That for which cash has been given</td>
<td>Sources from which cash has been received</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Debtors to the business</td>
<td>Creditors of the business</td>
<td></td>
</tr>
</tbody>
</table>

Source: Sprague, p56 (Row numbers column added).
The foregoing is not meant as a destructive criticism of Sprague's writing since, as far as his text is concerned, it is of no matter which phase is selected. In the preparation of accounts, the crucial point is to adopt a particular row so that a consistent theme is used in all three parts of the balance sheet. However, he does show that various phases of liabilities are possible.\textsuperscript{177} Thus provided is a structure to understand the possibility of different definitions of the element liability, leading to debate thereof.

Sprague's structure and analysis is consistent with his (p3) definition, 'An account is a systematic statement of financial facts of the same or opposite tendency leading to a conclusion.' No matter what row is selected, all parts of the balance sheet may be systematically explained in like terms. The analysis is also consistent with Sprague's concern with algebraic and classificatory matters and with his presentation of a rationale of 'accounts'.

But what of the content of the balance sheet? On what grounds is a particular row (and the preferred definition of liability) to be selected? Sprague does not consider here questions like these at any length.

The various phases of liabilities are simply listed in the chapter 'Phases of Liabilities' without detailed discussion (p49, paras 115, 116 and 117). Those phases in which the definition of 'asset' is the essential characteristic are highlighted (p49-50) by the comment, 'Ordinarily there is no designation of certain assets as destined to meet certain liabilities, but any or all of the assets may, upon default, be expropriated to a sufficient extent to pay any liability.' Earlier, he (p43) wrote, 'No one asset need correspond to any particular liability.'

In these cases, it would seem that to establish whether or not a particular item is a liability, then it must first be established that assets exist, generally of amount sufficient to meet the claim. If so, then the item is a liability. In some cases, an asset and a liability may be directly related.\textsuperscript{178}

However, the relationship between assets and liabilities becomes confused when the chapter is concluded (p51) by the paragraph, '122. While assets may shrink in value, that shrinkage affects the proprietorship, never the liabilities, which must be regarded as rigid and inelastic.' Questions arise:

- What happens if the assets shrink in value to such an extent that their value no longer exceeds the amount of the liabilities?
- Does the liability cease to exist?
- Does proprietorship assume a negative value?

\textsuperscript{177} For instance, given the eight possible phases of the parts of a balance sheet, the process by which accounts are prepared remains unaffected by which phase is selected. However, the one phase must be consistently adopted for all three parts. It does not of course follow that the content of accounts in general and the balance sheet in particular will be identical under all phases.

\textsuperscript{178} Of items like a mortgage loan with specific collateral, Sprague (p51) writes, '120. While there is this correlation between assets and liabilities taken in pairs, there is seldom exact identity of value. The asset is already taken, or intended to be taken, larger than the liability, for prudential reasons; so that there is a residue above the liability such as the equity in the mortgaged property or the margin in the loan on collateral.'
These matters are not discussed, though Sprague (p62) does introduce at a later stage a notion of negative proprietorship which he terms ‘insolvency’. However, this is referred to as an exceptional set of circumstances.

A final argument supporting ‘liabilities’ being an item for investigation in its own right and not dependent on ‘assets’ is Sprague’s (p43) comment on a municipal corporation.\(^{179}\)

Implicitly, it is possible to prepare lists of liabilities and their amounts without direct resort to assets.

The stated aim (Preface) of Dickinson’s *Accounting Practice and Procedure* is to introduce to students and those not trained in accounting, problems encountered in practice and suggested solutions thereto. He (1913, p31) saw the aim of accounting as enabling the financial condition of an entity to be ascertained. However, he argued that while some claimed generally that the balance sheet was a factual representation of financial condition, in practice this was not the case. Instead, it was at best a good approximation (p32). He also refers to convention, though not necessarily in the same sense as Yamey (2.6.2) or May (4.3.2).

There was certainly no analytical reasoning of Sprague’s rigorous type. There is description and discussion of items to be disclosed. Indeed, Previts (1974) lauds Dickinson’s contributions to professional issues of the time and the role of format suggested in the text (p64). The latter were the forerunner of those included in professional pronouncements in 1917 (see 3.3.2) and in 1929 (see 4.2.2).

In line with the ideas of the importance of ‘character’ met in 3.2, Dickinson (p249) too saw accounting problems being resolved by resort to the qualities of the accountant.\(^{180}\) Similar arguments are found in 4.4.

A development at this time of interest to this study was the contiguous argument of the economist Fisher (1906, p264). He was to incorporate the economist’s approach to the quantification of wealth and the related income using future expectations and capitalisation of discounted values, arguing that similar reasoning could be applied to accounting.\(^{181}\) Fisher (p265) did acknowledge the assumption of ‘the existence of

\(^{179}\) Sprague (p43), ‘It has liabilities also; but no balance can be struck between its assets and its liabilities which will define its status to any instructive purpose. Lists of its assets so far as ascertainable are valuable; lists of its liabilities are even more so; but its proprietorship cannot be reduced to dollars and cents and hence its balance sheet is non-existent.’

\(^{180}\) Dickinson (1913, p249), ‘... ability, coupled with tact and honesty, to ascertain facts without friction and with impartiality; a mind unbiased by previous conceptions, and free to reach independent and reliable conclusions of fact; and a will strong enough to maintain such conclusions against the arguments, opinions, or desires of opponents interested in some opposite or inconsistent conclusion, and yet to adapt such parts of their arguments as may throw new light on the questions at issue. With such qualities, and with the added technical training and practical experience which are equally necessary, the individual is in fact an accountant qualified to deal with many questions ... and to add new principles ... ’

\(^{181}\) Fisher (1906, p264) argues, ‘From the foregoing accounts it is clear that the theory of capital and income which has been explained applies practically to the accounting ordinarily employed in business. Such accounting is, in fact, nothing but a method of recording the items of income and their
artificially simple conditions ... that the entire future history of the capital in question is definitely known in advance...' Fisher's ideas would influence his student and early accounting writer Canning (1929) whose work is introduced in 4.2.2. This approach deals with economic income - seen as an ideal 'measure' towards which a 'conventional accounting/financial' income should be aimed.\(^{182}\)

Sprague (1907, p38) did question parts of Fisher's argument, especially the explanation of a fictitious person who held assets and in turn owes them to real people. Sprague suggested Fisher, the economist,\(^ {183}\) in his reasoning had been misled by the lazy habit of bookkeepers of calling all credit balances liabilities.\(^ {184}\) Sprague (p47) easily accepted Fisher's argument that all assets were capital (and not the idea that Proprietorship was capital). Fisher's definitions of assets and liabilities in terms of future benefits/service potential would have major influences on CF deliberations some 70 years later (see Chapter 7).

Sprague also saw business in terms of increasing wealth - an economic term. Indeed, two chapters were titled Economic Accounts (p67-78) and The Economic Summary (p79-89). However, he (p79) saw the latter as Profit and Loss which provided a view of the economic history of the period. The Summary of the Economic Accounts (p87) also reconciled the final figure with the figure which appeared in the balance sheet. The synonymous use of economic and financial while clearly evident here, was potentially questionable.

An issue met at the Institutional-professional level was the use of audited balance sheets for credit-application purposes. This was a diversion from the idea of reports for a more general audience. Instead, they might be prepared for say a banker. Hawkins (1962, p227-228) traced an interest in these reports to 1913 when the American Association of Public Accountants provided suggestions on format (Previts & Merino, 1998, p228-229). A more widespread adoption of an accountant's certificate as a prerequisite for credit applications followed, providing more work for these professionals.

capitalization at different points in time. A merchant's balance sheet is a statement of the prospects of his business. Each item in it represents the discounted value of items which he may expect later to enter in his income account. Rightly interpreted, the capital account merely represents as a whole the capitalization of expected items in the income account; the fluctuations of the capital account correspond with the deviations from the standard income in the items of the income account; and where there are no such fluctuations, every item of the income account is equal to the standard income from the corresponding items of the capital account.\(^ {185}\)

\(^{182}\) The concept is now relatively well known in the empirical methods found in research using stock market prices. Ball \textit{et al} (2002) use the concepts of economic income (p1) and accounting income (p3) in testing hypotheses on the quality of reporting in selected countries.

\(^{183}\) Paton (1972, piii) recalls that in 1912, he was taught accounting principles by a professor of economics who, though an excellent teacher, knew nothing about accounting.

\(^{184}\) Sprague (p20) takes issue with the practice, "Those who use this ... often contradict themselves by saying that the proprietary account is the excess of assets over liabilities; but if the proprietary account is one of the liabilities there cannot be any excess!' This practice was still followed by some in the 1970s (Staunton, 1974, p4-5).
This overlapped with Information tensions. Various users of financial data were highly critical of the accounting profession’s practices and ethics. Smith (1912, p252) argued that causes of audit abuses included a lack of scientific method in accounting and the lack of uniform principles and terminology. He believed, like Sprague, that accounting was not an ethics-based system but an exact science. This made it amenable to definite rules built on definite axioms capable in practice of producing definite and exact results. He saw the responsibility for this resting with the professional accounting bodies. He sought definite rulings from the profession on the correct accounting treatment of such items as depreciation, bond discount and organization expenses. The variety of accounting treatments of these items often confused the non-accountant. He argued prescription in these areas would, in turn, minimize potential abuses by the dishonest banker or promoter. Others, including Dickinson, were not impressed (Previts & Merino, 1998, p207).

Various solutions were suggested by the FRB and FTC to problems arising from variations in the ways similar items were included in financial reports. These included establishment of uniform accounting systems for all major corporations, possibly on an industry basis, or the creation of a Federal register of public accountants whose work was acceptable. The former was to be consistent with the work being done internally within corporations.

The appeal for accounting data based on uniformity at the application level would be echoed by others, very shortly by the FTC. Later writers, including Chambers, would argue for uniformity at the underlying reasoning level.

3.2.3 Reporting of liabilities
The balance sheet to be filed under the 1908 UK Companies Act was to contain a summary relating to liabilities. Particulars disclosed were of general nature (Hein, 1978, p233; Edwards, 1980, p38-39).

To some, the development of universal prescriptions was uncalled for in accounting, especially when transactions were few and relatively simple. Lybrand (1908-9, p39) and Walton (1908-9, p454) for instance found no problems regarding the liability section of a balance sheet. However, as pointed out in 3.2.2, Sprague for one sought reasoning underlying a universal definition.

Sprague discussed the concept of liability in an orderly fashion. Having established that a balance sheet is comprised of assets, liabilities and proprietorship, the equation (p23) ‘Assets = Liabilities + Proprietorship’ provided a basis for an analysis of ‘transactions’ (p26) or ‘occurences’ (p23) into debit and credit entries.

Although the term liability is used frequently throughout his analysis, it is further discussed only in the case of indebtedness arising directly from an increase in

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185 Lybrand (1908-9, p39), ‘The liabilities usually call for no particular comment, as, if they are clearly stated, they will be self-explanatory.’

186 Walton (1908-9, p454), ‘There is not much uncertainty in regard to the liabilities, as usually the only point to be settled in regard to them is as to whether they are included in the accounts. Occasionally it is found that the liabilities that are accrued, but not due, are omitted from the calculation …’
assets.\textsuperscript{187} To some extent, the analysis is incomplete. It is at a much later stage that an illustration is found of a liability which arises from an occurrence that does not directly affect assets.\textsuperscript{188} No discussion is included of liabilities which arise from a decrease in proprietorship. Another possible relationship not discussed is the case of a change in the composition of liabilities.\textsuperscript{189}

Items which Sprague states to be (or not to be) liabilities are:

(a) Indebtedness

In the construction of an account, a notion introduced is that of ‘indebtedness’ arising when monies are borrowed by or lent to the proprietor for whom the account is being prepared. The term ‘proprietor’ is used deliberately as Sprague does not use the notion of an ‘entity’ which is distinct and separate from the proprietor. He does refer to ‘a fictitious entity’ (p38) and ‘The Business’ (p57), but the usefulness of the notion is only begrudgingly admitted.

Having constructed a ‘Cash Account’ (p15), Sprague (p16) points out that one particular class of items in that account represents ‘indebtedness’ among various parties. Individual accounts are drawn up to illustrate the indebtedness, one for C.D. who is indebted to the proprietor and another for A.B. to whom the proprietor is indebted. In the case of the former, ‘C.D. is called our Debtor, and we are his Creditor’ (p17), while in that of the latter, ‘A.B. is truly a creditor.’ (p18) The term ‘liability’ is used for the concept of indebtedness to creditors, as shown in the illustrative balance sheet reproduced in Figure 3.2.

Figure 3.2

<table>
<thead>
<tr>
<th>ASSETS</th>
<th>LIABILITIES</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash on hand</td>
<td>Due to A.B.</td>
</tr>
<tr>
<td>$69</td>
<td>$12</td>
</tr>
<tr>
<td>Due from C.D.</td>
<td>PROPRIETORSHIP</td>
</tr>
<tr>
<td>$17</td>
<td>$74</td>
</tr>
<tr>
<td>$86</td>
<td>$86</td>
</tr>
</tbody>
</table>

Source: Sprague, p20, Figure 16.

Sprague (p20) explains, ‘On the right are first, all claims against the assets, designated as the liabilities: second, the remainder unclaimed, or the net assets free from liability,

\textsuperscript{187} For example where cash is borrowed or merchandise purchased on credit.

\textsuperscript{188} See for instance interest accrued and interest payable (p74) or dividends payable (p84).

\textsuperscript{189} An example would be a bill payable issued to a trade creditor in lieu of that debt.
Various known as proprietorship, capital, stock or simply by the name of the proprietor. Terms used for the indebtedness to creditors vary throughout the text. See for example, ‘Mortgage’ (p33), ‘Personal Creditors’ (p38) or ‘Mortgage Payable’ (p39). The relationship between liabilities and proprietorship is next considered.

(b) Proprietorship
Sprague (p20) expressly comments on the problem met in reports in which the term liability is used to describe one side of the balance sheet. Sprague points out the contradiction. Later (p30), when discussing the balance sheet, he notes that liabilities and proprietorship ‘instead of being of the same nature … are sharply antagonistic.’ He does not, however, propose a term (like equities) to describe a major class of which these two elements are parts.

(c) Bills payable
An illustration (p38) introduces this as a liability. No comment is offered on this item, although it does provide a basis for discussion of problems which may arise in determining the amount of a liability.

(d) Accumulated depreciation
On some balance sheets of which, presumably, Sprague had notice, accumulated depreciation was shown among liabilities. Sprague (p58) is adamant in his disagreement with such a procedure, writing, ‘This depreciation is not a liability, although it is frequently listed among the liabilities.’ Sprague’s claim here is noteworthy in the context of where to include in the balance sheet items like proposed alterations to, renewals of and replacement of assets (Staunton, 1974, p4-8) and fluctuations in the value of assets (Staunton, 1974, p8-13).

(e) Interest accrued and interest payable
A brief reference is made to an ‘Interest account’ which may create a liability at balance date. Sprague (p78) concludes, ‘Interest Receivable, Interest Due, Interest Accrued, Interest Payable are assets or liabilities…’

(f) Dividend payable
A distribution of profit to owners is included in the accounts by way of a proposed dividend. In the illustrative balance sheet in Sprague’s (p84) Figure 36, ‘Dividends payable’ is revealed as part of ‘Total Liabilities.’

Unlike Sprague’s careful analysis of liabilities, Dickinson’s discussion, as concluded in 3.2.2, tended to be a description and review of items shown as liabilities. This is found within discussion of the balance sheet (p41-45) and a chapter titled ‘Balance Sheet Liabilities’ (p127-152). It would certainly be placed at the application level.

However, times were changing. Insurance companies (and other financial institutions) were required to address ‘risk’ in their commercial products. Actuarial assessments

190 Sprague (1907, p20), ‘I can see no benefit in lumping the $12 and the $74 together and calling them all “liabilities.”’

191 Dickinson was a Fellow of the Institute of Actuaries and Previts (1974) points out Dickinson’s graduate studies were in mathematics.
had long been undertaken and reporting was required (Nobes & Parker, 1979, p198; Edey, 1979, p224). Interest and hence discounting were parts of operations, as discussed in later chapters.

Other debates were found. While none questioned whether bonds met requirements of being a liability to be reported, problems arose from management's dealing with related discounts and premiums (on issue or redemption). Various ways of the reporting would provide management with discretion to manage that reporting.

Sprague (1906, p294) and May (1906, p175-176) debated the nature of bond discount while Hallett (1906) questioned the apparent distinction in treatment of discounts and of premiums. May (p176) based his reasoning on the idea of conservatism in the accounting methods used.\(^{192}\)

Sprague (1906, p294) objected to May's making 'a distinction in practice between discount and premium, which I think is unfounded and unsupported by facts'. Sprague did not argue the points at length, although May (1906a, p32) later argued 'practical difficulties' outweigh Sprague's 'logical consistency' in establishing accounting principles.\(^{193}\)

Hatfield (1909, p187-188) discussed the difference between effective and nominal rates of interest and how they might be useful in calculations of the expected prices of a bond already issued. Arguments here were later used in debates on the measurement of those bonds.

During the same period, debates were found regarding contingencies as liabilities. Despite the absence of an unequivocal definition of 'liability', that contingent liabilities have some effect on accounting has been appreciated for many years. Post (1905-6, p183-184) included a specimen statement form prepared by the New York State Bankers' Association. Total liabilities (other than Net Worth) included notes payable, accounts payable, mortgage debt and chattel mortgages; also included was a list of contingent liabilities.

Roberts (1905-6, p467) wrote that practices followed to cast a rosy glow over an otherwise gloomy statement included a failure to disclose a liability for paper rediscounted. Hatfield (1909, p32) suggested a major weakness of double-entry bookkeeping as it was then practised was that it 'does not even attempt to show the actual condition of the business, in that to a large extent it ignores contingent

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\(^{192}\) In that this was in 1906, the stage was set for the accounting principles until the 1930s. Also, May noted that 'the great railroads' no longer capitalised outlays of a revenue character. Instead, such outlays were written off against current income or surplus or amortised over several periods. Again, the stage was set for accounting principles becoming a description of what was the present practice of accountants for the particular matter.

\(^{193}\) May (1906a, p32) replied, '... as regards his broader contention that absolutely no distinction should be made in practice between the treatment of premiums, and the treatment of discounts, I can only refer to the arguments and the statement of practical difficulties given in my paper which appear to me to make such a distinction necessary. It is true that making a distinction involves some inconsistency, but accountancy is full of similar inconsistencies.'
liabilities.' This had been a criticism of the information content of reports prepared from the double entry bookkeeping system.

Hatfield's discussion of contingent liabilities appears as a part of the broader area of contingencies in accounting. The calculation of monetary amounts is another concern. While Hatfield does not clearly distinguish among various issues, that he is concerned with contingencies and their treatment may be inferred from Table 3.1. After identifying various contingencies, the recommended treatment of the related credit balance is as part of owners' equity, liability or part of the monetary amount of asset. This is compared with what is usually done.

Table 3.1

<table>
<thead>
<tr>
<th>Contingency</th>
<th>Recommended Treatment</th>
<th>Usual Treatment</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Reserve</td>
<td>Liability</td>
</tr>
<tr>
<td>Guarantees</td>
<td>Yes</td>
<td></td>
</tr>
<tr>
<td>Trade Paper</td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>(a) Acceptances &amp; Indorsements given</td>
<td>Possibly</td>
<td></td>
</tr>
<tr>
<td>(b) &amp; Discounted</td>
<td></td>
<td>Yes</td>
</tr>
<tr>
<td>(c) Issue own note &amp; offer collateral</td>
<td>Maybe</td>
<td>Maybe</td>
</tr>
<tr>
<td>Depreciation from 'economic changes'</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Hatfield (Chapter XIII, p233-260, 'Surplus and Reserves') also discusses reserves for extensions, for bad debts, for additional guaranty to creditors, for special or unforeseen emergencies, for equalizing dividends and for insurance. Hatfield did not reconcile these reserves with the items in Table 3.1.

The treatment afforded various 'credit balances' in practice led to debate on items which were seen as not being liability, owners' nor negative asset equity items, suggesting a distinct classification (Thym, 1912; Patterson, 1912).194 The Editor (1912) was not impressed by the suggestion.195 This idea would later be recycled (see Chapter 8).

194 Henderson (1974, p334) would later make the same suggestion.

195 Editor's comment (1912, p561), 'We fear our correspondent's remedy would prove worse than the disease. What a happy retreat the twilight zone of unclassified debit and credit sheet would prove for
3.3 World War I and the aftermath

The ultimatum France and Russia received from Germany after the assassination of Archduke Ferdinand in 1914 caught international financiers and markets unprepared for WWI which followed. Panic hit various stock exchanges, including NYSE which closed for some five months (Sobel, 1968, p328-35).

When the NYSE reopened, arguably economic power shifted to USA. The initial panic was followed by a lengthy bull market (Sobel, 1968, p346-49). With a now sound banking system supported by the Federal Reserve, prosperity followed (Sobel, 1965, p202, p211-13). The 1916 presidential campaign was waged on USA's potential entry into WWI rather than matters related to big business.

When Wilson declared war, the allies received access to the credit facilities of the USA government. Various war bond/loan issues were heavily oversubscribed, in turn leading to high activity on NYSE (Sobel, 1965, p216-7). Over the next two years, concern with activities of big business waned (Hawkins, 1962, p123).

An increased number of small shareholders in large corporations exhibited what was called the 'investment motive', revealing an interest in the corporation's affairs and performance instead of simply its share price – the latter being seen as the primary interest of a speculator. This meant growth of a market for information, both financial and non-financial, about those corporations including the so-called investment fundamentals - earnings, assets, industry trends etc. This was especially so as now selected industrial stocks were seen as being of investment class, previously dominated by railroad and government stock (Hawkins, 1962, p205; p344-5; Sobel, 1965, p222-3).

This industrial investment phase was to be the province of the security analyst – one of note being Collver (1917). Differences were noted between the techniques previously used to appraise railroad securities and government bonds and those for an industrial security. Users of financial data from an annual report complained of an absence of accepted standards of industrial accounting and an apparent unfettered capacity for financial statements to conceal rather disclose. One suggestion was for uniform forms of accounting for the different industries (as for railways) regulated by some government agency (Hawkins, 1962, p266-271; Previts & Merino, 1998, p229-234). The notion of different external financial accounting for different industries had its genesis.¹⁹⁶

The processes underlying investment were also to change. Formerly the process had been one of reliance on the banking house. The banker would analyse for customers, with whom a fiduciary relationship existed, the enterprise and the related security (using financial reports from management). The banker, being primarily concerned with the safety of the investment, concentrated on the balance sheet. Accepted

¹⁹⁶ Around the same time, Clark’s (1923) 'different costs for different purposes' would emerge in internal accounting.
solvency ratios (like ‘current’ or ‘quick’) were calculated and arguably the exit price of assets considered. As well, the going-concern value of assets was considered which needed the income statement as well. The latter was shortly to be considered the more important (Hawkins, 1962, p348-353; Sobel, 1965, p223).

One group, IBAA, while not denying that instances of fraud existed, questioned the common belief as to the extent of the fraudulent dealings in securities. Hawkins (1962, p151-178) observed it was argued that the public should distinguish between its members, as legitimate dealers in securities, and those “fly-by-night” operators. Regulation was needed for the latter only. Otherwise, legislation would interfere with business.197

Management’s actions were still primarily conditioned by a belief that caveat emptor applied in commercial transactions and that information about the affairs of industrial corporations, being essentially private relationships, was no business of stockholders, investors and consumers, let alone workers. They had no right to expect ‘full and fair’ disclosure of corporate affairs. The critics, on the other hand, sought publicity of both financial and non-financial information to protect various groups (Hawkins, 1962, p124-125).

This period produced an extension of the planned economy in many countries. A continuum would emerge from Communist state to the taxed welfare Capitalist states. Arguably, production and stability were gained at the expense of some restriction of freedom of action. Unrestricted competition was curbed as competition was not among an infinite number of small producing and selling units. Rather, it became a struggle among a few giants with each other to control supply, entry into markets and consumer outlets (Berle, 1954, p156-157).198

Like other nations wearied by WW1, there was a reaction against the preceding progressive era. General economic growth199 and widespread business prosperity was followed by increased public share ownership and a widening of the gap between the control and ownership of corporations (Hawkins, 1962, p186). 1919 would also see the refinement of Ponzi’s scheme of pyramidng (Sobel, 1965, p223-24).

USA experienced a depression in 1920-21 with a major drop in wholesale prices with implications for the funding and sale of inventory. The bankers’ emphasis on liquidity issues and their short-term horizon resulted in a movement towards the use of long-term funding via stockholder capital for inventory investment. Emphases moved from liquidity to profitability and earning power in analysing corporate financing. The income statement (rather than the balance sheet) would, arguably, become the major report (Chatfield, 1977, p72-73). The resulting crash was foreseen by some who sold

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197 Their initial opposition was modified when in 1917 a Supreme Court decision removed any possible constitutional barrier to the States’ ‘blue sky’ legislation.

198 For instance, the Achnacarry plan sought to ease potential warfare among powerful commercial and national interests after British, French, and American oil companies sought to control development in the Persian Gulf area (Berle, 1954, p156).

199 Goldberg (1949, Part IV) argues the USA emerged in a much stronger position than before WW1.
short, making large profits on share realizations. The funds would be reinvested in following years in various schemes and speculations (Sobel, 1965, p246-247).

Once Wilson (weakened by the 1918 swing of the political pendulum to the right and completed by the election of Harding in 1920) had departed the political scene, businesses like JP's old firm were allowed to take advantage of an era of unprecedented prosperity gained from open market operations (Vallance, 1955, p83-84; Hawkins, 1962, p188-189; Sobel, 1965, p224-225; Jackson, 1984, p317-318).

3.3.1 The UK scene
Concerns about the disappointing performance of selected UK corporations were forgotten in the challenge of wartime conditions (Green & Moss, 1982, p35). UK, along with other countries, suffered major social and economic costs from the casualties of WWI. A litany of events[260] from the Great War and its aftermath included:

- an orgy of profiteering,
- an orgy of careless spending,
- social honours bought and sold,
- war-time profits from shipping freight,
- Germany to be billed for the costs of the War,
- a 1919-20 inflationary boom in UK,
- unprecedented currency inflation in Germany – the hyperinflation of 1921-24, and
- some less but worrying currency inflation in other European countries.[261]

The general price-level-type events in UK and Europe in turn led to questioning of the accounting convention of a stable monetary unit (Sweeney, 1964; May, 1943, p47; Noguchi & Edwards, 2004, p280-281).

The economic boom (especially in 1914-1916) by business in USA (though not necessarily shared by stakeholders like workers) was certainly at the expense of UK (and other European) parties. Indeed, in 1914 the London Stock Exchange for the first time was closed (Vallance, 1955, p84; Sobel, 1965, p208, p217-218).

260 Vallance (1955, p83) summarises: 'In that conflict and its cynical aftermath more was spilled than blood: faith was lost in the professions and promises of statesmen; and the "patriotism" which poor Edith Cavell said was "not enough" masked an orgy of profiteering and careless spending while millions died "for their country" or returned to unemployment. Honours were bought and sold: Cardiff, with its record of millions made from war-time shipping freights and public-spirited gifts to Liberal Party funds, became known as "the city of dreadful Knights". In London, the first post-war Parliament of "hard-faced men who had done well out of the war" had been elected on Lloyd George's pledge that Germany should be made to foot the bill to the last farthing, and that England should be a land "fit for heroes to live in". What the heroes were destined to experience was the wild 1919-20 inflationary boom and the slump of 1921, followed, in Germany, by an unprecedented currency inflation – paralleled, in minor degree, by France and other European countries – which dispelled the illusion that the cost of war could be met by exactions from the impotent defeated.'

261 Green & Moss (1982, p41-66) give some insights into problems faced by commercial firms in UK after 1918 in their Chapter Four. See also Bresciani-Turroni (1931); Holtfrerich (1986).
As regards the requirements of the UK Companies Act, the Wrenbury Committee Report (1918) continued the themes of earlierActs (Aranya, 1979, p268; Nobes & Parker, 1979, p199; Edwards, 1980a, p71-74). Secrecy in commercial affairs (especially regarding profit and its components) persisted (Hein, 1978, p253-254).202

The brief boom in 1919-1920 provided a fertile ground for those who took control of companies (including those in the cotton industry and Dunlop Rubber). The corporation, often with activities concerning subsidiaries, would quickly grow.203 Noted here were the activities of Clarence Hatry.204 More discussion of his activities is found in 4.2.1. The unfortunate result was the consequence of techniques used - the ‘watering’ of capital and bull speculations - which were profitable for some but ruinous for many small investors (Valiance, 1955, p88-89) in the depression that followed.

3.3.2 Accounting interactions
In 1916 the AAPA was disbanded and reincorporated as the AIA (Previts & Merino, 1998, p196). In its earlier days, it, like other professional groups, was chiefly concerned with institutional tensions like

- organizational issues,
- certified public accountant legislation and
- competition from other accounting groups (Hawkins, 1962, p226).

As well, the FRB sought the use of audited financial statements by commercial bankers in their loan-making decisions, but both it and the FTC showed concern about the highly variable quality of financial reporting about corporations (Zeff, 2003, p191). This need for reliable financial statements of issuers of commercial paper saw the promulgation of an authoritative guideline titled ‘Uniform Accounting’ (FRB, 1917) for the conduct of independent audits - the first ‘standard’ in the accounting area developed by the profession. It dealt with issues of format of the balance sheet and profit and loss statement, along with guidance on auditing procedures. Little was found on issues of principle.

The statement was issued and renamed ‘Approved Methods for the Preparation of Balance Sheets Statements’ (FRB, 1918). Being still more concerned with auditing

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202 Edwards (1980a, p73), ‘We have made enquiry whether a profit and loss account ought to be included. We do not recommend that itbe required. As a commercial matter publication of profit and loss ought not to be required in the absence of very strong reason, and we do not find that such reason exists. To require from a corporation a public disclosure of profit and loss which is not required from a firm or an individual, gives an unfair advantage to a competitor in trade and does not commend itself to our judgment.’

203 Walker (1978, p23, footnote omitted) concluded, ‘If holding companies were still few in number immediately after World War I, business conditions were such as to cause more businessmen to look closely at this form of organisation… a short-lived post-war boom, together with a loss of export trade, the challenge of imports, pressure for improved working conditions and the formidable costs of replacing obsolete equipment all encouraged business combinations as a means of reducing competition and minimising costs.’

204 Manley (1976, p51) writes, ‘He first comes to notice in the post-Armistice boom of 1919-20 in connection with a rash of reorganizations and rationalizations, most of which were to suffer heavily in the slump of 1921 and the subsequent deflation.’
procedures, effectively little was achieved as regards reporting standards (Zeff, 1972, p117-119).

The pamphlet was prepared from the point of view of the grantor of credit, not the general investor. It sought to improve and standardize the form of financial statements and encourage the adoption of independent audit methods. Its authority came from the prestige of AIA and the sponsorship of the FRB. Compliance with it was voluntary. While an Editorial (1917, p45) did endorse a policy of full disclosure, the AIA would for a number of years concentrate on the promotion of the publication with its practice/procedure emphases (Editorial, 1919, p454; Hawkins, 1962, p217-225).

Potential for misuse of audited financial statements was also of concern (Editorial, 1920, p299-300). However, any blame was placed at the feet of management or underwriters (Editorial, 1925).

Yet, regarding Information tensions, some found a preoccupation with the ‘system’ rather than with issues of the quality of the output from that system. Montgomery (1919, p7) for one argued that while the balance technique was useful as a bookkeeping type control, it remained subservient to the output of the system, especially regarding the quality of its information and its use.

Whilst it is difficult to identify ‘firsts’ historically, Montgomery’s argument is certainly an early professional-type reference to the ‘substance over form’ debate. Chambers (1999, p122 & 127-128) also argued that issues of form had usurped the common knowledge and meaning of ‘financial position’ and ‘income’. The argument had arisen from the CGB case (recall section 2.6) and subsequent case law had made clear that the phrase (found in the Companies Act) ‘as shown by the books of the company’ did not mean the auditor had simply to check the balance sheet against those books (Edey, 1979, p225).

While no causal relationship is suggested, the work being done in accounting on underlying reasoning and its linkage to economic notions such as wealth (like that of Sprague met in 3.2.2) would see some questioning of the use of the term balance sheet. Montgomery (1919, p6-7) did not support its use. He saw a statement that

205 Montgomery (1919, p7), ‘Balancing has so overawed bankers and business men that many of them would as soon remove an ancient land-mark or make light of sacred things as strike out one figure on a balance-sheet and insert another. The chief use of a statement which balances is the smug satisfaction it affords to the bookkeeper. It does not signify accurate or trustworthy accounts.... I can't emphasize too strongly the importance of getting at the substance of a balance-sheet and subordinating its form.’

206 Montgomery (1919, p6-7): ‘The term itself is ill-chosen and I am sure that it at least is partly responsible for the curse of balancing. The trouble with most balance-sheets is that they balance.... Instead of a balance-sheet (which always balances) bankers should call for a statement of assets and liabilities and if it balances it should be returned for correction. Very frequently balance-sheets upon which large amounts of money are lent are exactly what the name implies, that is, certain figures are extracted from the debit and credit sides of ledgers and in turn are transferred to sheets of paper without any intelligent thought being given to the relationship of the figures to the things which the figures are supposed to represent.... The ideal balance-sheet is one which does not balance because in such case no one fears to decrease an asset if it is over-valued or hesitates to increase a liability item or insert an additional liability if it is found that all are not on the books.’
differed from a ‘list of balances’ – leading to a tension which would continue until current times (see Chapter 7).

3.3.3 Reporting of liabilities

While during this period, emphasis remained firmly on issues of form and application, debates on definition and measurement, often implicitly, continued. As regards bonds, Webster (1913, p174) noted the generality of various state and commission regulations on the treatment to be afforded bond discount and sought development of a theory to guide applications. Two years later, Bennett (1915, p5) acknowledged various practices still persisted. Beck (1917) contended that various arguments were based on ‘mere dicta’ rather than on any compelling underlying reasoning.

Dickinson (1913) proposed bond discount be amortized by the interest method (or some approximation thereto) so the ‘interest’ capitalised is the sum of both nominal interest and past bond discount. This suggests the expense ‘interest’ is calculated at the effective rate. Bennett (1915, p7) reported that this view (with selected exceptions) was also supported by the ICC. However, the state utility commissions rejected this view.

Differing and conflicting viewpoints continued to exist on whether other expenses might be added to any discount (Bell, 1918, p182-183; Finney, 1919; Armstrong 1920, p18). That conflicting interpretations were possible can be further evidenced by the mixed advice given in the Students' Department (Walton, 1915, pp390-391; Walton & Finney, 1918, p150).

As regards contingencies, Hurdman (1914, p449) suggested various kinds of reserves were possible. These included those dependent upon some future contingency. Another class of reserves consists in merely providing out of earnings for any contingency which may arise. He did suggest no particular object is gained by such a reserve unless a corresponding amount of cash is held or invested in some security, for the purpose intended. A mere book entry did not accomplish any real purpose in his opinion.

Leamy (1918, p167) found it difficult to treat all contingencies consistently. Dohr (1919, p174-177) in his Exhibit A headed ‘Schedule of Accounts’ included under Liabilities both those termed Contingent and those termed Special. Unlike Leamy, Dohr suggests actual accounts for these liabilities. He also included under Proprietorship

- reserve for contingencies
- reserve for sinking funds
- reserve for sacks
- reserve for reduced output and inactivity.

207 As a reason for such generality, Webster (1913, p174) suggested, ‘None of these regulations is very specific but this is probably accounted for by the fact that until a comparatively recent date it was customary to charge discount on at least an original issue of bonds to capital and it is, therefore probable that future regulation will develop the theory in more detail...’

208 The former included ‘Notes receivable discounted’ and ‘Claims’ while the latter included ‘Contracts for future delivery.’
This classification of accounts reveals an intermingling of ideas prevalent for treating 'contingencies' under both liabilities and proprietorship. The possibility of effects for assets also exists.

Others suggested reserves be established in reports for mining enterprises to account for all contingencies so that 'the true status of all obligations' may be shown (Hooker, 1920, p245-246). That a line of demarcation was required between 'reserves' included as part of owners' equity and 'provisions' which are liabilities was raised by Finney (1921, p70). He reported that the AIA in an examination in accounting theory and practice asked candidates to define 'contingent reserve'.

Confusion surrounding the characteristics of liabilities in general and links among particular applications is well illustrated by Hurdman (1914). He dealt with the stated 'liabilities',

- taxes payable,
- interest payable, and
- rent payable,

referring to two distinct levels of thinking - the legal notion of 'due' and the personal quality 'conservative'. Debate remained inherently insoluble.

3.4 Summary and conclusions
The early decades of the twentieth century were times of revolution around the world. Some countries would opt for one or another form of socialist system and organizations. In USA, the capitalistic system continued with the chief instrument of the capitalist revolution proving to be the modern giant corporation (Berle, 1954, p164).

In this chapter, major social and economic changes were identified. In USA, the new century saw the control of the corporation being fiercely debated. Reforms were suggested and partly introduced which continued to include publicity via accounting reports as one type of control – leading to information tensions. Others fiercely resisted those initiatives, demanding privacy and secrecy. The so-called Progressive era would be swamped by events of WWI and its immediate aftermath which saw further major social change and difficult economic issues and political times. In UK, similar events dominated social and economic conditions.

Argument
3.11 Corporate management tended towards a view of confidentiality and secrecy, demanding more latitude in reporting.
3.12 Selected other stakeholders demanded greater publicity.

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209 The suggested solution read, 'A contingent reserve is an account with a credit balance, set up by a charge to profit and loss or surplus, representing a provision out of profits for an uncertain future loss.' This 'definition' (admittedly virtually worthless by present day standards) highlights the various problems which arise in an analysis of reserves and provisions.

210 Hurdman (1914, p448, emphasis added), 'The discovery of taxes or interest amounting to several thousand dollars, not shown on the statement, but due soon thereafter, may alter your opinion as to the security for the proposed loan. It will be stated frequently that no liability should be set up for taxes, interest, rent, and such items until the amounts are due, but the correct and conservative method is to accrue these items periodically so that the earnings and financial condition may be accurately stated.'
3.13 Selected other stakeholders demanded increased regulatory overview, perhaps under uniform applications and reporting.
3.14 Self-regulatory processes, including 'the market', were debated.
3.15 'Moral regeneration' was suggested as a solution to overcome various questionable practices.
3.16 Personal qualities, like training and heritage, were raised as potential self-regulatory processes, including via professional development of standards.

During this period, a number of leading corporate managers and their critics were seen as reactionary in that they were out of step with the changing social and economic conditions. Management generally saw demands for greater publicity as part of the attack on big business - as something to be repelled (Hawkins, 1962, p89, p124). Drives for increased CG and regulatory oversight met subsequent counter-moves by pro-business forces, including stock exchanges and the newly established accounting professional bodies. It will be shown that debate would recur throughout the twentieth century and into the new millennium.

**Argument**

3.21 The corporation is analysed more as an economic organisation relative to the previous legal approach.
3.22 Argument is made for reporting selected risk factors.
3.23 The ability of investors to interpret corporate financial statements is questioned.
3.24 Effort tends to be expended on issues of format at the expense of questions of principle.
3.25 Quality of information produced and links to issues like format – the substance-over-form argument – are not explicitly established.

In the meantime, accounting was not immune to change. The rote-learning of technical rules required support from underlying reasoning. Introducing and analysing that reasoning would lead to information tensions between the preparers of reports, often the accountant in practice, and the users.\(^{211}\) While the former tended to stress form, the latter sought consistency among reports of a high quality.

The growing importance of the accounting professional groups led to institutional tensions. At the infrastructure level, those groups would have a key role in establishing the bodies to develop the guidelines for reporting, even to the extent of having input into legal controls. As well, professional issues like the accountant’s liability for negligence in providing services and its extent would require consideration.

**Argument**

3.31 Accounting professional groups face emerging institutional tensions.
3.32 Accounting professional groups make submissions to inquiry committees.
3.33 Some effort is expended on underlying reasoning of accounting (an academic approach) relative to issues of application.
3.34 Sprague introduces the notion of reciprocity which has implications for identification and measurement debates on assets and liabilities.
3.35 Fisher introduces economic ideas of future expectations and discounted values which are to be applied in accounting - a going-concern valuation.

\(^{211}\) Be they investors, lenders of money, investment advisers, employees, consumers or regulators.
Issues concerning the reporting of liabilities still tended to be those of classification. However, questions of underlying reasoning and different applications in practice were being asked.

Argument

3.41 Sprague provides reasoning underlying issues concerning liabilities.
3.42 Actuarial assessments are well established with potential application in accounting in general and for liabilities in particular.
3.43 Some suggest a 'third place' on the equity side of the balance sheet.

Issues met in analysing corporations would see emphasis continue to move towards matters more of an economic kind. This change in emphasis would continue, as further analysis and discussion in Chapter 4 will show.
Chapter 4 The Framework: Corporate Governance in the Twentieth Century
Between the World Wars - The Dominant USA Influence

In the twentieth century the centre of accounting development moved to the United States of America. While the nineteenth century was the century of British predominance in commerce and industry, the twentieth century has witnessed the fulfilment of the American industrial potential to an equally marked degree. And in this attainment the part played by accounting has been neither inconspicuous nor insignificant.

Goldberg, (1949, Part IV)

4.1 Introduction
In this chapter, the analysis and discussion of changes in selected social and economic matters continue. The context provided is the between the two World Wars period and interactions with accounting in general and the reporting of liabilities in particular are identified.

The excesses of the 1920s, the stock market crash of 1929 and the Great Depression are first considered (4.2). Next, the New Deal period (4.3) is discussed - a period in which, inter alia, much was expected from government to take action to curb manipulations and other abuses. These included those of an accounting type, leading to debate on whether bodies like the FTC (and later the SEC) should provide the reasoning and standards underlying financial statements. The accounting profession was to play a key role, arguing for self-regulation and the adoption of conventional accounting. This was to become entrenched as the basis of financial statements for some decades and is here termed the May Legacy (4.4). Finally, a summary and conclusions are provided (4.5).

4.2 The Excesses of the 1920s
If a rascality index was constructed, some argue the top rating would go to the freewheeling twenties, which would make previous times seem quite tame (Sobel, 1965, p235, p250).

It is commonly stated that none of the administrations of Harding, Coolidge and Hoover presented a threat to business or the bullish Wall Street (Vallance, 1955, p84-85; Carey, 1969, p35; Jackson, 1984, p318). In 1922, NYSE’s representatives perceived little need for legislation (de Bedts, 1964, p6; Previts & Merino, 1998, p238). Big business had a fairly free hand under the laissez faire policies of those administrations. With economic prosperity, large demands for capital, a decline in criticism of big business, the advent of the public-relations specialist, an

212 This is not to suggest that tensions were absent. One illustration is provided by de Bedts (1964, p93). In 1928, Calvin Coolidge was looking for someone to direct an investigation into the public utilities companies [often granted monopolies by the government in industries like electricity and water] that Congress had authorized. Since Coolidge considered this investigation inexpedient, he looked for someone to head the inquiry "who would not dig deeply enough to open any wounds." … Judge Healy was made chief counsel of the FTC to carry out the project, an appointment Coolidge lived to regret. Healy provided damning evidence to House and Senate committees (p53) and would go on to become one of the original SEC commissioners (p88) as met in the next section.
unprecedented scale of new securities being issued and any regulation of the securities market absent (or in the hands of people sympathetic to business interests), history has shown that mismanagement and abuses were inevitable. Blame would be placed on unbridled speculation\textsuperscript{213} in the stock market (Hawkins, 1962, p188-189).

Dillon (1977, p117-118) summarized the position in the 1920s as one in which there was lack of any effective control or regulation of stock markets. That was despite a case being made that various exchanges had potential to provide appropriate self-control (May, 1943, p55).

While disclosure of financial information might be used as a potential control device, it was also to be used by investors in their decision-making. An academic, Ripley, wrote a series of articles in the semi-professional press, *The Atlantic Monthly*, called ‘Main Street and Wall Street’\textsuperscript{214} (Chatov, 1975, p18-19; Zeff, 1979, p208; the articles were published in book so titled in 1926). It aptly described the situation wherein Main Street\textsuperscript{215} (representing individuals, small enterprise and ‘the public interest’) had become interlocked with Wall Street (representing the stock market and large business interests). Ripley (1926, p167-170) sought financial information about corporate affairs for a variety of reasons:

- it was part of publicity which was a ‘governor’ of big business,
- employees needed it for bargaining purposes,
- investor advisors required it, and
- it was necessary for an effective and efficient market in securities.\textsuperscript{216}

Ripley (1926, p181) complained,

> How ridiculous that public partners in this enterprise, consulting banking experts, should have to be advised that such an official income account “does not by any means give a clear picture of the annual earning power” or that “the balance sheet by no means discloses the true value of a company’s fixed assets.” It approaches public scandal that corporations of such importance should thus play

\textsuperscript{213}Given that consumers were interested in consumption rather than agitation against big business and that investors and speculators both sought capital gains rather than protection, some argued this period in many respects resembled the early 1700s period of the South Sea Bubble. Economic and social seeds of disaster were being sown in the form of speculation, unsound business consolidation and the breakdown of the fiduciary tradition (Hawkins, 1962, p189-190).

\textsuperscript{214}In 4.3, a key person mentioned is A A Berle Jr, a student of Ripley. The classic *magnum opus* by Berle and Means (1932, p310-311) had its genre in this period and contained instances of questionable accounting practices including manipulation of inventory values, of depreciation, of the treatment of the liability ‘bonds’ and related interest, of other asset values and of the reporting of ‘profit’.

\textsuperscript{215}This phrase is the title of Sinclair Lewis’s (1920) Pulitzer Prize winning book. It was seen by some as quite satirical and non-representative of a typical USA small town. Other disagreed, finding it a welcomed reflection of life in such a town. Ripley comments (1926, pxiv), ‘I have confessed the theft of a part of my main title to Mr. Sinclair Lewis, the distinguished author of *Main Street*. He has been pleased to send me his “Godspeed” in the enterprise.’

\textsuperscript{216}Grady (1962, p57) suggested a fundamental change in the 1930s by NYSE in its attitude toward listed companies was undoubtedly partly a result of Ripley’s argument dealing with publicity in corporation accounts.
fast and loose, not only with the public, but with those whose capital is really invested in the business.

Ripley’s main theme was the need for better information to be included in accounting reports, as seen in his various laments.\footnote{217 These included, ‘To the uninitiated, as we shall soon see in detail, they may tell too much that is not so, or too little of what they ought to tell’ (p164); ‘Stockholders are entitled to adequate information, and the state and the public have a right to the same privilege’ (p165); His ‘detail’ (p171) included a case in which a loss of $421,000 was presented in the financial reports, by a feat of accounting legerdemain, as a profit of $459,000. This figure compared favourably with the trend of profits for the previous two years. He commented (p198), ‘All these, moreover, are certified to by a highly reputable firm of accountants. Being only an economist, I confess utter inability to unravel it.’}

Indeed, by comparing Ripley’s arguments with say Clarke et al (2003), some may question the progress made. While management of corporations may presently report regularly and often in quantity, criticisms made by Ripley continue to present times\footnote{218 Dean (2003, piii), in a plea to accounting educators, argues, ‘[W]e should seek ways to inculcate in our students a desire to inquire and to improve our discipline. We should move away from producing automaton students - merrily repeating the conventional wisdom and dogma of the past... While conventional accounting practice generally persists, so do the criticisms.’} to be debated. There remain matters such as

- provision of glossy pictures instead of quality information;\footnote{219 Ripley (p163), ‘Yet colored pictures of factories, brightly lighted at night, - as some of these must well have been in view of their extraordinary success, - tell no tales.’}
- the argument shareholder indifference warrants little factual information;\footnote{220 Ripley (p169), ‘A prime argument which raises its head at the outset of all discussion of shareholders’ participation in direction is that the shareholder – the owner, in other words – is hopelessly indifferent to the whole business. His inertia as respects the exercise of voting power, and almost everything else, is an acknowledged fact. But no one expects it to be otherwise. ... Nor is it true that the primary purpose of publicity, the sharing of full information with owners, is to enable these shareholders to obtrude themselves obsequiously upon their own managements. But such information, if rendered, will at all events serve as fair warning in case of impending danger.’}
- the need for both the balance sheet and the income account and on the function of the former;\footnote{221 Ripley (p171), ‘The two essentials of an adequate statement are the balance sheet and the income account. The former disclosed the condition of the company statically – as at a given moment. It is an instantaneous photograph, giving a cross section, so to speak ... Each is essential to a complete understanding.’}
- difficulties in reporting on holding companies;\footnote{222 Ripley (p202), ‘The holding corporation is a peculiarly troublesome and confusing business as respects accounting. Even with the best of intentions it is extremely difficult to set forth the true condition of affairs, either as to the estate itself or as to the current income therefrom.’}
- the treatment of ‘goodwill’ in accounting reports;\footnote{223 Ripley (p192), ‘Ware of a company with a huge item of goodwill on its balance sheet! ... Goodwill, in other words, is the outward expression of inward unsubstantiality.’}
- fraudulent acts being hidden for a time through non-disclosure in reports.\footnote{224 Ripley (p192), ‘Ware of a company with a huge item of goodwill on its balance sheet! ... Goodwill, in other words, is the outward expression of inward unsubstantiality.’}
In sum, severe pressure continued on accountants to provide more reliable, high quality information in accounting reports.

The 1920s were to see the plundering of funds set aside for economic restructuring, tax evasion, misrepresentation, incompetence and general swindling of investors (Previts & Merino, 1998, p249). While the purchasing habits of investors were undoubtedly often of a speculative type, not the result of in depth analysis, reporting practices of that time would be questioned in the ensuing havoc (Nerlove, 1930). Ripley sought publicly available information, supported by legislation if needed, as a general remedy to corporate transgressions.

Ripley’s remedy (1926, p222-225) was that if self-regulation failed, government regulation of corporate disclosure practices would follow, probably through the FTC. While agreeing with his claim of inadequate reporting, business and finance persons who commented upon Ripley’s work found the remedy too drastic, some hinting of it leading to socialism (Hawkins, 1962, p283, p287-288). For example, Richardson (Editorial, 1926, p281), while finding the argument important, thought the remedy of intervention by the FTC not useful and too bureaucratic. Preferably, reform would stem from the efforts of private sources, including the AIA. Ripley’s proposals were debated by May (1926, p321), who argued for control of the setting of accounting guidelines by those in the private sector, namely the accounting profession.

A later Editorial (1927) would suggest Ripley’s effect was minimal. This would be shown to be untrue by developments met in 4.3. The stock market collapse of 1929 saw contemporary debate on causes and/or effects (Chatov, 1975, p20-22). An Editorial (1929, p445) laid blame on speculation. Implicitly, little was said of the information provided in any accounting. Some argued issues (other than accounting practices) were at play in the 1920s - a period of extensive technological, cultural and economic change (Sobel, 1965, p229; Dillon, 1977, p60). Almost all aspects of USA life were affected. Some responsibility for the following securities

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224 Ripley (p178-179), ‘Mystery was treated as an asset, on the ground that publicity would be too informing to competitors. Dividends were paid entirely from capital ...; the bubble burst; and the assets were bought in for less than one tenth of the face value of the securities sold.’

225 Even Coolidge supported Ripley’s suggestions for corporations to supply more complete and accurate financial data. However, perhaps for convenience, it was argued the remedy rested with the states (Hawkins, 1962, p286-287). Others too would provide support (Rorem, 1928; 1928a).

226 Ripley’s views would be included in the philosophy followed by those (including some of his students such as F D Roosevelt and Berle) in setting up the SEC as part of the New Deal (see 4.3).

227 Interestingly, Richardson (Editorial, 1928, p32) would argue for the enactment of laws to govern financial disclosure in prospectuses.

228 Editorial (1929, p445), ‘The astounding feature of the decline and fall of the stock market in late October and early November was not the fact of descent itself, but the altogether unreasoning consternation which the public in and out of Wall Street displayed. There was nothing at all in the course of events which distinguished the break from its many predecessors. Month after month, even year after year, market prices of securities had climbed to even dizzier heights. Now and then a Jeremiah uttered warning and lament, but the people gave no heed. They thought and consequently dealt in far futures... The unseen was the chief commodity.... Anything was possible when vision was so blurred by success.’

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market crash was to be attributed to the inability of stock market institutions to adapt quickly to change. Others were not so sure that accounting was immune to any criticism.

Consequences of unfettered competition, inadequate provision of quality accounting data and inadequacy of regulation were to be provided by the Kreuger and the Insull sagas.

The Kreuger case is often cited to highlight Kreuger’s ability to raise funds to create a world-wide match empire. As regards this study, the lack of quality accounting information being publicly available is more to the point (Flesher & Flesher, 1986, p421). In USA, he linked his International Match Company (IMC) with the then eminent accounting firm Ernst & Ernst but, it would be revealed, he kept the books secret. As auditors, they would support expectations of well-being to the public in general and investors in particular. Kreuger was, just before the great crash and his own demise, called ‘the wonder man of the age’ in a *Time* cover story and acclaimed by distinguished economists (Vallance, 1955, p155-156; Sobel, 1965, p245-246, p271).

The original Kreuger & Toll (K&T) vehicle, incorporated in Sweden, became an investment company after Kreuger established the Swedish Match Company (SMC). Both were under his control. However, SMC’s growth was threatened by the depreciation of various European currencies from post-war events. IMC raised millions of dollars in share and debenture issues, often with the aid of eminent USA banking groups. These funds were in turn transferred to Kreuger’s European interests. Some investments there were sound, while others were less so. One in which a French government loan to Morgan & Co was refinanced, provided some tensions with Morgan interests. Other uses were for Kreuger’s own personal requirements (Vallance, p157-159).

Kreuger’s interests seemed unaffected by the Wall Street crash, though some questioned how large profits and high dividends could be maintained. However,

229 At this time, even simple requests from the NYSE for reports were not followed by all. Arguably, the main concern was for more disclosure with little thought of the content or its quality. Corporate management, over whom NYSE had little control (other than by moral persuasion), still fought against any publicity or disclosure, even if for new listings only. Given the inadequacy of statutory regulation, the work of the NYSE to improve reporting of corporate affairs to the investors was to some noteworthy in that it was in advance of the existing legal requirements of the day or the requirements of the accounting profession (Hawkins, 1962, p246-251).

230 Grinaker and Barr, (1965, p486) write, ‘The sudden and complete collapse of stock market prices in 1929, and the severe and extended depression which followed, aroused the stock exchanges, the federal government, and the general public to the need for reliable financial information. These groups were further aroused when several fraudulent stock manipulations were disclosed. These financial scandals usually involved the selling or trading of securities in corporations using fraudulent and unaudited financial statements. In this environment there was a need and a demand for strict controls over those securities transactions in which the general public were involved.’

231 Clarke et al (2003) recount similar episodes of laudatory comments related to CEOs/Chairpersons before more recent corporate collapses.

232 Mixing public and private interests has a long history. What is critical is that all parties are made aware of the financial risks and returns where such potentially conflicted interests exist.
economic collapses in Europe, including the German moratorium, meant a cash crisis for SMC and K&T. The situation in K&T was compounded by UK accountants’ investigations into cash from finance raisings moving among group members. His suicide saw the group collapse (Valiance, p160-163).

A later investigation found

- some bonds were forged (to improve the perceived collateral of the empire),
- accounts juggled, and
- low-grade securities substituted for high-grade ones.

Witnesses were called from Ernst & Ernst but no one could say how much had been misappropriated. Dummy banks created by Kreuger and falsification of accounts suggested how it had been done. May, of the investigating accountants Price Waterhouse, admitted that little examination of the books had occurred before the financial statements were certified.\(^{233}\) Certainly the 1930 balance sheet presented a false impression (Valiance, 1955, p163-165; Sobel, 1965, p286-287).

Valiance (1955, p164-166) concluded social, economic and financial issues from the case included:

- the importance of silence and secrecy in the success of the conspiracy,
- the importance of control of the processes and data from which accounting reports are prepared,
- the state of auditing,
- the role of international bankers, and
- profits earned by brokers and financial institutions issuing related securities.\(^{235}\)

\(^{233}\) Such an observation by May was unlikely to satisfy investors. His views are summarised in May’s testimony before USA Senate Committee on Banking and Currency in 1933, reproduced in Hunt (1936a, p104-111).

\(^{234}\) Valiance (1955, p164-166): ‘How did [Kreuger] get away with it? Asked once to explain the secret of his success, he said to his interviewer: “There are three things. The first thing is silence. The second thing is more silence. The third thing is still more silence.” Concealing from his associates and supporters the immense ramifications of his huge conspiracy, retaining in his hands alone the “inner” books from which accounts and balance sheets were compiled – the concealment aided by the very lax auditing stipulations of Swedish law [and perhaps worldwide?] at that time – he persuaded the greatest international bankers that he was the world’s most powerful man ... His crash certainly deepened the Great Depression; and the Americans, the worst sufferers, were bitter against his memory. Yet they might have reflected that, if Kreuger funnelled so many good dollars out of the United States, the process was carried on by good American bankers on a still greater scale. Between the end of World War I and Kreuger’s death nearly twelve billion dollars’ worth of foreign bonds had been marketed in the U.S. – to the considerable profit of the issuing houses – and a high proportion of these fruits of “enlightened self-interest” was lost. Lee, Higginson & Co. – ruined by Kreuger’s fall – were reported to have netted $6 million in (gross) promotion profits on his New York heyday flotations. Moreover, though fraud was not proved, the collapse of a domestic “empire” – that of Samuel Insull – was soon to demonstrate to American investors that not only foreigners could part them from their money.’

\(^{235}\) As with new millennium sagas like Enron, facilitating finance from banks and other financial institutions was crucial. The Economist (2005d, p7), ‘J. P. Morgan Chase agreed to pay $2.2 billion to settle its part in a class-action lawsuit, led by the University of California, that accuses several banks of aiding Enron in defrauding investors before the energy trader went bankrupt in December 2001. Last week, Citigroup said it would pay $2.0 billion to settle its part in the suit. Both banks deny any wrongdoing.’
In the Insull case, his empire (see 3.6.1) expanded greatly during this period, the corporate structure becoming almost unwieldy. Vallance (1955) described the structure as a ‘top-heavy pyramid’, reflecting the layer upon layer of holding companies and trusts.\(^{236}\)

The investigation found the pyramid had been successfully balanced (until its collapse) by the real profits of the electricity industry which were enormous in this period. Also, there was “padding” of profits. The FTC found fictitious profits a normal feature of reports. Various Insull interlocked companies were used to inflate turnover and assets by inter-company operations. As well, Insull used holding companies and a complex system of cross-financing to repel potential raiders or takeover. The pyramiding made millions for insiders and brokers (Valiance, 1955, p172-174; McDonald, 1961, p150-151; Sobel, 1965, p287; Previts & Merino, 1998, p266-268).\(^{238}\)

Vallance (1955, p175-176)\(^{239}\) intimated a series of social and economic issues which are of interest to this study, including:

\(^{236}\) A diagram, presented in Clarke et al (2003, p166), highlights the complexity.

\(^{237}\) Vallance, 1955, p172) commented, ‘Insull was to undertake dozens of such operations as his domination expanded, and in each the role of the holding company was essentially the same – until, by the end, he had piled companies, one on top of another, six deep. By the end, Insull was sitting on the Boards of 85 companies, was Chairman of 65, President of 11; and he was controlling more than six thousand electricity, gas and ice-making plants. The trouble was that those who invested in the securities were dependent, for dividends, on the income of the holding company. This, in turn, drew its income from its holdings of common stock in the actual utility concerns – and this stock was out of all proportion to real earning power.’ This was of course a recipe for a financial Ponzi.

\(^{238}\) Others too used the holding company technique and related pyramiding to control capital and assets in companies like the Alleghany Corporation. Finance would come in part from Morgan sources (Sobel, 1965, p245).

\(^{239}\) Vallance (1955, p175-176): ‘Insull, however, was more than a typical American “tycoon” with a shrewd sense of the use of politicians who could act to the good or detriment of his undertakings. He was a great political power, and a passionate opponent of public ownership of electricity – a cause that had been gathering momentum all through these years and triumphed after the election of Franklin D. Roosevelt. Nothing helped Roosevelt more, in his fight to establish the Tennessee Valley Authority and other public power projects against the bitter hostility of the utilities, than the failure of Insull. It is significant that Insull crashed just as Roosevelt was first nominated ... as Democratic candidate for president, and his very first campaign speech was directed against “the Insull monstrosity”. Insull went to fantastic lengths to defend private monopoly ownership of power, even buying up uneconomic power plants to prevent cities from taking them into municipal ownership, and securing alterations favourable to the Power Lobby in the civics textbooks used in Illinois schools... The Insull empire, and all its strange financial ramifications, therefore, provided ammunition for the reform movement which culminated in the New Deal. In its rise was the embodiment of all that American radicalism distrusted: in its fall, it gave proof that what Insull called the true “economic theories of ex-President Hoover and Mr. John Rockefeller Sr.” were the cause of the downfall that ruined millions of Americans and threw them on the streets and into the breadlines. His argument that public power was “constitutionally unsafe, politically unwise, economically unsound and competitively unfair” sounded unconvincing to the men who were selling apples at the street corner. His denunciation of his critics as public enemies of truth, reason and fact seemed a little strange when he sponsored an attack on the Society of Friends, the United Society of Christian Endeavour, the Central Conference of American Rabbis and the National Women’s Christian Temperance Union – as “Bolshevik fronts”.'
• use of politicians (social),
• private or public ownership of electricity power (social and economic),
• reform policies of FDR (social and economic),
• collapses and ruin of investors (social and economic), and
• economic theories - recourse to ideas of Hoover and laissez faire,
  - recourse to ideas of Rockefeller and unfettered market forces.

These have accounting interactions at both infrastructure and information level which are discussed in 4.2.2.

As late as 1928, despite the FRB’s successful efforts to improve the minimum standards of financial disclosure for credit purposes,\(^{240}\) little influence was had on corporate financial data reported publicly. Once again the secrecy mantra was chanted, claiming this information would assist competitors. Great variety was noted in the quality, form and content of the listed company’s audited statements. No guarantee of adequate disclosure or comparability between the financial statements of different companies was given. It was argued this diversity resulted from public accountants being hired, in general, by management for whom they thus acted, so management controlled the financial statements (Hawkins, 1962, p230-234).

Cooperation between various private-sector groups was seen as the preferred method of standard setting for disclosure of information. The accounting profession and NYSE met for this purpose, as did the profession and investment bankers (Editorial, 1928a, p285).\(^{241}\) This sought maintenance of standard setting in the private sector, thus thwarting government regulation.

The accountants sought more ‘full and frank’ information for investors, while the bankers sought “standardization” of accounting practices (and arguably ultimately, principles). While not mutually exclusive goals, each group had hidden agendas. The former wanted increased adoption of audits; the latter wanted uniformity of accounting practices to be able to compare more easily the financial statements of different companies. Others were examining the underlying accounting principles. They found a lack of rigorous and uniform accounting standards which allowed management to manipulate, misrepresent and conceal information related to corporate activities (Hawkins, 1962, p234-238).

Evidence of abuses was neither clearly seen nor publicly admitted in the atmosphere of 1929 (Chatov, 1975, p20). Voices of caution were raised but limited to the more clearly seen speculative nature of stock activity (Sobel, 1965, p266) and inherent conflicts within the financial securities market sector. The governor of New York, Franklin D. Roosevelt (FDR),\(^{242}\) criticized the speculative fever (de Bedts, 1964, p9).

\(^{240}\) When the FRB did move, its actions were challenged by a private group linked to Wall Street interests. Some sought return to the age of Morgan (Sobel, 1965, p268).

\(^{241}\) This is further discussed in 4.2.2.

\(^{242}\) FDR was to play a key role in later developments as discussed in 4.3.
Administrations at that time had muted responses to a need for financial and general corporate controls and for improved regulation of the securities markets. Hoover's reactions to complaints of stock exchange actions were limited to the evils of short selling and excessive speculation on margin. Of the public losses resulting from market pools rigged by exchange insiders little was said. Protection of the public from securities fraudulently issued was not mentioned, other than periodic pleas for better business ethics. In 1930, however, Hoover saw potential trouble from the operations within the NYSE itself. Whitney, the new NYSE head, was strongly urged by Hoover to curb the manipulations of stocks by insiders. However, Whitney was informed there was no plan for Federal controls as regulatory powers rested with New York State (de Bedts, 1964, p12; Sobel, 1965, p269, p284).

The Senate expanded its investigative powers to include private banking. After evidence had been uncovered, the relentless questioning of committee counsel Pecora exposed the so-called favoured list of the Morgan 'friends'. These included the names of judges, political leaders, cabinet members, bankers and industrialists.

Also uncovered was potential manipulation. While NYSE was depicted by its own authorities as being an impartial forum for the free play of supply and demand, it was in reality neither more nor less than a glorified gambling casino. Odds were heavily weighed against eager outsiders. A later inquiry would reveal that in 1929 there were operating pools, syndicates, joint accounts, or the like in not less than 105 public stocks listed on the NYSE. As well, the popular press was accused of assisting speculators and promoters to dupe unwary investors (Sobel, 1965, p248-9, 285).

While the market for securities was seen as the ideal in which 'market control' was possible, the market required corporate financial statements. This in turn would require the development and enforcement of standards for those statements.

243 That bodies like the NYSE did not have the required controls in place was later supported by Subcommittee of the Committee on Currency and Banking (1933, p30) which observed, 'The true function of an exchange is to maintain an open market for securities, where supply and demand may freely meet at prices uninfluenced by manipulation and control. In the past this function has been fulfilled most imperfectly.... The tendency (of representatives from the stock exchange) has been to belittle reports of manipulative activities as unfounded rumors, unworthy of serious attention. The evidence adduced before the subcommittee has thoroughly discredited this attitude.'

244 The practice of course had much earlier precedents. In the case of the South Sea Company (met in Chapter 2), the use of share being offered to (especially political) friends was found.

245 Each received a 1000 or 2000 block of stock in the Morgan holding company, the Alleghany Corporation, at the cost of $20 per share. At that time, the market price was $35-$37 per share. The usual accompanying letter advised that there were 'no strings attached' and that one might sell whenever one wished (de Bedts, 1964, p44-45).

246 Dillon (1977, Chapter 3) discusses both the idea and the erosion thereof. See also Previts & Merino (1998, p241-242).

247 More recently, West (2003, p4) concluded, 'During the past hundred years, the onus for discharging this responsibility has been substantially placed with accounting practitioners. Both individually and through their formal associations, accountants have played the major role in designing accounting procedures and overseeing their application.'
Whether a rules-based or principles-based accounting system should be followed would be debated.

4.2.1 The UK scene
During the 1920s, questioning occurred in UK of the use of accounting reports. Evans (1974, p27) commented on debate on the use of balance sheets. Others found selected balance sheets as being 'models of obscurity'. During this period, as already noted in USA, the profit and loss account replaced the balance sheet as the primary financial statement for assessing progress made by and prospects of an enterprise (Edwards, 1979, p284).

In 1922, consolidated accounts were presented for the first time in UK and Garnsey's text (1923) on that topic followed (Nobes & Parker, 1979, p199). Garnsey (1926, p273) hinted at differences between economists' needs and those involved in commerce. The former sought balance sheets dealing with economic and/or financial realities rather than legalities. Arguably, this would show the 'true' performance during the period and the 'true' economic position of the company at that date. Here, distinguishing among the terms economic, financial and legal seemed poorly based. He (1928, p52-53) suggested that while economists argued that information sought was hidden, other stakeholders in financial disclosure had different viewpoints. To reconcile different views were to him problems of social philosophy rather than accounting.

The Greene Company Law Reform Committee of 1926 was the precursor of the Companies Act of 1929. By this time, organized accounting bodies were of sufficient repute to receive invitations to submit memoranda (Hein, 1978, p353; Edwards, 1979, p276; Edwards, 1980a, p113-120). The ICAEW was part of the group which opposed a requirement for additional disclosure by management. Opposition was based on the beliefs that most directors and management were honest and disclosure undesirable as it helped competitors (Aranya, 1979, p268; Edwards, 1979, p277).

The Committee considered inter alia the question of secret reserves. Interestingly, the infamous RMSP saga was about to be revealed. The organized accounting groups and various commercial bodies both testified that such reserves were indeed desirable (Garnsey, 1928, p46-47; Hein, 1978, p223; Edwards, 1979, p279-280; Edwards, 1980a, p102) and no direct action was taken. The practice of 'smoothing' profits (or managing earnings) was approved.

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248 Edwards (1979, p278) argues, 'The fact that there was a decline in reporting standards may well be a reflection of the fact that businesses were hard pressed during the early 1920s. In the immediate post-war years industry was faced with particular problems of re-adjustment, both in order to fulfil the requirements, internally, of a peace time economy, and to cope more effectively with the changing pattern of world trade.'

249 Evans (1974, p27), 'The exact purpose for preparing a balance sheet was a widely debated topic in the 1920s in the UK. This is perhaps understandable in view of the uncertainty of accountants in earlier times ...'

250 This phrase was used in an exchange between McLintock and Burgess, the Senior Official Receiver in Companies Liquidation (paras 633-635) in the evidence before the Greene Committee (1926), see Edwards (1980a, p75-125).
While most who testified argued that the publication of the profit and loss statement was either impractical or undesirable, the Committee recommended its availability to shareholders (Hein, 1978, p254-255; Edwards, 1980a, p82-83). Accounting professional groups argued that the form of the statement should be left up to management. Others sought prescription of the details of the trading account (Hein, 1978, p260-261).

The Committee paid significant attention to the presentation of group accounts of a group of inter-related companies. Various methods for presenting the affairs of holding and related subsidiary companies were discussed. Garnsey (1923, p18) argued that the advantages of presenting the ‘legal’ balance sheet of the holding company only, included

- information being hidden from competitors, and
- an ability to equalize the income of the parent.

He did however, concede (p19-20) that a disadvantage was that shareholders may not receive information to which they were entitled.

Objections by a number of hostile witnesses to the provision of consolidated statements were based largely on the argument that the accounts did not represent financial facts of legal entities. Organized accounting professions, while somewhat divided, agreed (Hein, 1978, p274-275; Edwards, 1980a, p113-114). Garnsey (1923, p52-54) preferred the method by which the legal balance sheet of the holding company and a summary of assets and liabilities of subsidiaries was published. Disadvantages of this method included

- effects on the position of a creditor of a subsidiary who might be misled of the legal state of that claim,
- the lack of uniformity in the classification of assets and liabilities, and
- the various ways by which assets could be valued.

Little has changed, as similar issues continue to be debated (Clarke & Dean, 1993; Clarke, Dean & Houghton, 2002).

A UK recession in 1926-1927 caused difficulties for USA economy, as did the re-establishment of the gold standard (Valiance, 1955, p85-86; Sobel, 1965, p265). Green and Moss (1982, p68-78) show these difficulties exacerbated problems faced by management like that of RMSP.

The Companies Act 1928 and Companies (Consolidation) Act 1929 expanded the accounting requirements of the 1907 Act by specifying the contents of the balance sheet and including the filing and tabling of a profit and loss account (Haldane, 1970, 251

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251 Until then, while those groupings were known, the use of consolidated financial statements was not widespread (Garnsey, 1923, p59; Hein, 1978, p272-273).

252 Edwards (1979, p281) concluded, ‘It is clear that in the [Greene] Committee’s view nothing should be done to disturb the existing state of the law, in the absence of any major financial disaster.’ Few would expect to see a failure like RMSP to occur so soon after the enactment of the new Companies Act.
Management still had considerable scope to obscure in the reports. The various requirements were most general in nature, as illustrated by some practices found regarding reporting of liabilities. This set a trend that would continue until the 1970s in which the legal system endorsed 'accepted best practice' (Evans, 1974, p32).

On one side, the reformers would argue shareholders, creditors and the general public required information of a set kind to be externally reported. On the other, accountants as a pressure group would argue that they produced something rather different. As shown in 4.2.2, May advocated the need to stress the 'limitations of accounts'. In UK, Garnsey (1928, p50-51) too would stress the limitations of even the best accounts. They were a combination of conventional and real figures.

The collapses of the Hatry group and the RMSP, with revelations including dubious use of secret reserves, shocked the City and some in USA (Sobel, 1965, p269). Arguably, Hatry was badly treated in the popular press and by the presiding judge in his trial (Vallance, 1955, p134-135). While he was certainly one of the promoters of the time to profit from various rationalizations, it is suggested his financing (of borrowing needs of city municipalities) and amalgamation (in particular industries including steel and iron) schemes were reasonable in economic terms and employed the legal 'parent-and-child' technique.

After the withdrawal of promised bank support following the unexpected return of a Labour government, scrip certificates were used to temporarily 'borrow' funds. This was risky but it was expected any temporary certificates would be quickly withdrawn and destroyed (p140-142). Rumours of troubles in the Hatry group of companies circulated in the City, and an investigation by Garnsey followed, leading to the trial, conviction and jail sentences (p143-144).

However, the effectiveness of the latter was questionable as in some cases management literally laid it on a table at the company meeting, making the information in the statement out of the reach of most ordinary shareholders (Hein, 1978, p270).

Edwards (1979, p283) cites the following, 'The balance sheet of the Imperial Tobacco Co. Ltd. for the year to October 1928 included the item, "Creditors, provisions for taxation and bonus to customers, estimated capital liability under dividend guarantee; amounts set aside for contingencies and to meet fluctuations in the value of leaf tobacco stocks, employers' liability, marine and other funds", L14,628,828 ...'

This 'difference' has become known as the expectation gap in corporate financial reporting and remains a continuing tension among stakeholders.

This had similarities with the Kreuger and Insull sagas.

Green & Moss, (1982, p3), 'While not denying the importance of the Royal Mail case in the development of accountancy and company law, the starting-point of this study was the evidence that the inter-war history of the Royal Mail Group was of much wider significance, especially in the development of relations between the City and the government.'

Edwards (1979, p286-287), 'Although some dissatisfaction with financial reporting and auditing practices was expressed, in some quarters, during the period immediately following the passage of the Companies Act 1928, it is unlikely that anyone foresaw a disaster of the magnitude that was soon to befall accounting and the accounting profession.'
Vallance (1955, p144-145) felt very sympathetic to Hatry’s plight.259 A more critical view of Hatry’s activities is provided by Manley (1976). He questioned Hatry’s honesty, as under the scheme, financial means were often used to justify ends once they are achieved. ‘Financial probity’ would vary as business practices change.260 The role of lax controls in municipal borrowings was questioned, reform of Local Authorities legislation quickly following.

Manley (1976, p53) also questioned the promotion of companies with short-lived aspirations under a ‘parent-and-child’ scheme – a practice then common. Prices of such shares were easily manipulated in trading by related companies. Regarding disclosure requirements of the stock market, Manley (p60) concluded that the case had minimal influence on disclosure in UK, claiming that a *laisssez faire* philosophy of disclosure continued to be followed. He criticised the practices of bankers in lending decisions. Some dealt with attitudes whereby more concern was placed on form rather than *substance* of the security offered. This was most obvious in the bankers’ acceptance as security of share certificates which were in reality worthless. Others dealt with controls within a bank whereby obvious double-counting in terms of collateral was not detected.

In a spirited response, Walker (1977, p80) questioned the claim of a philosophy of disclosure in UK statutes pre-1929.261 He based his argument on past Committee findings and provisions of related statutes, including those of the Greene Committee, concluding disclosure rules in the 1920s were both limited in scope and ineffectual. Disclosure being seen as more demanding than that in most USA states, few UK commentators saw much wrong with the then regulation of securities markets.262 Both the Hatry and RMSP collapses provided the required shocks necessary to challenge attitudes to the state of disclosure in UK.

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259 Vallance (1955, p144-145): ‘The system under which Corporation and General Securities acted as banker (without being a bank) for borrowing municipalities was quite wrong; it was a temptation to fraud. So was the accepted procedure of issuing temporary scrip certificates which could be used as collateral for loans. Here an acquisitive society can fairly be said to have “merited its criminals”. The use made by Hatry of “unauthorised” scrip was clearly illegal; but whether it was more fraudulent than the usage (common in the City) of “finance bills” drawn on itself by the borrowing firm (“pig on pork”, in City parlance) is questionable. The proof of honesty is ability, when the time comes, to pay; and, in this respect, Hatry had bad fortune... But, once again, it was too late for Clarence Hatry. The “god of fair beginnings” tires of his favourites at sixty-odd.’

260 Manley (1976, p60) concluded, ‘Hatry’s one undoubted ability was that of borrowing. He was no ebullient confidence trickster. He worked according to the then rules of the financial world (or at least so close to them that the other players were unable or perhaps unwilling to perceive the “grey areas” in between. As we have seen, the “rules” or criteria for financial dealing were insufficiently precise. However, whatever criteria were and even now are set, a man sufficiently plausible, apparently successful and above all bringing good business, will, it seems, be allowed to fashion grey areas of his own.’

261 Instead, he suggested, ‘A more plausible interpretation is that the legislature resisted demands for fuller corporate accountability and was sympathetic towards appeals for business privacy.’

262 Indeed, Walker (1977, p80) cites the self-satisfaction felt in UK after Ripley’s comments on disclosure in USA met earlier.
Walker (1977, p81) found that little attention was directed at the scope or quality of financial information (especially of corporate groups) to be reported. Instead, reliance would be placed on the work of qualified accountants and auditors.

By 1929, the difficulties met by financial institutions in the need to rationalize and modernize UK economic infrastructure became of grave concern (Green & Moss, 1982, p91). Rumours of difficulties in RMSP group began just after the Hatry collapse.²⁶³

The business and related accounting practices within the group were seen to be questionable, especially the inter-group-company share holdings and the overvaluation of long term assets. As found in various unsustainable enterprises, practices like these may and can be used to report apparent sustainability, provided there is access to new money. Unfortunately for RMSP, it faced liquidity problems (Green & Moss, 1982, p93-103).

It was charged²⁶⁴ that the managing director, Lord Kylsant, had (with the partner of Price Waterhouse & Co, Morland, aiding and abetting), deceived shareholders of RMSP by publishing annual reports in 1927 and 1928 which were false in a material particular. As well, Kylsant, without Morland's participation, had published a false prospectus in 1928 inviting the public to subscribe to an issue of debenture stock (Vallance, 1955, p146-147).²⁶⁵

These criminal prosecutions were taken with some misgivings. Reviving arguments in the Whittaker Wright case (recall 3.2.1), to some, the alleged fraud lacked a motive, especially of personal gain. Instead, examination would be made of the financial administration of, and reporting by, RMSP since 1920. The crux of the matter here was the use of 'special credits'.²⁶⁶ Their legitimacy was questioned as they were perhaps used to deceive both actual and potential shareholders (Vallance, p147-149).

The aim of the reporting adopted was to even out the lean and fat periods. As evidence to the Greene Committee supra shows, business in general and accountants in particular had no objections to using 'secret reserves' in that way. However, some

²⁶³ Green & Moss (1982, p92) comment, 'The Hatry collapse had exacerbated the already deteriorating position of sterling, leading to an increase in the Bank Rate ... Neither the government nor the City could afford another public commercial scandal. To have been forced off the gold standard during a crisis would have almost certainly resulted in the collapse of confidence ...'

²⁶⁴ Details of the charges, court case and aftermath are further discussed in Brooks (1933) and Green & Moss (1982, p139-144).

²⁶⁵ Charges were laid under the 1861 Larceny Act.

²⁶⁶ These 'special credits' had arisen from various sources. One was from bonuses from related companies with large accumulated profits, including those from sale of steam ships and returns from insurance claims on sunken ships. A second was the distribution from the voluntary liquidation of a related company. The prosecution argued both these sources were non-recurring windfalls while the administration had reported them as a reserve. A third dealt with the provision for tax liabilities. RMSP was expected to pay Excess Profits Duty, but the government gave shipping companies a special obsolescence allowance in replacing war losses of ships. Such credits would be gradually taken back into profit and loss over time (Vallance, p149-150).
disquiet was obvious at RMSP, as ‘profit for the year’ was now termed ‘balance for the year’. Later, the qualifying omnibus phrase ‘including adjustment of taxation reserves’ was added. This was at the insistence of the accountant, Morland. Other accountants as expert witnesses would concur with that wording as being in line with current practice. The defendants were found not guilty on the charges relating to the accounts, but interestingly, Kylsant was found guilty regarding the prospectus charge (Valiance, p150-152).

The legal requirements regarding disclosure in annual reports (and prospectuses) were tightened following these cases. However, the dominance of management in (especially large) companies was noted. Valiance (1955, p153-154) concluded issues to come from the RMSP collapse included:

- the divorce of ownership from management,
- the now powerful role of management,
- practices like interlocking investments, group finance and the reporting of profit,
- potential abuses under this managerial system, and
- similarities to the Kreuger collapse (recall 4.2).

267 However, Edwards (1979, p287) cautions, ‘Both the general public and accountants were reminded of the functional nature of accounting reports by the financial collapse of the RMSP Co. The demerits of secret reserves were exposed as the result of the failure of the accounts of this company to provide any indication of impending financial disaster. The fact that the accounts were audited by a firm with an international reputation as leaders in their profession, and apparently prepared in accordance with normal accounting practice, merely served to emphasise the enormity of the lesson which had to be learned.’

268 Valiance (1955, p153-154): ‘My point is that, though they were acquitted of breaking the law in respect of the accounts, Lord Kylsant and Mr. Morland gave a (still pertinent) illustration of the extent to which management, divorced from ownership in a highly developed phase of capitalist enterprise, claims the right to act with the freedom of a dictatorship – action facilitated by interlocking investments, “group finance” and the common-form declaration of an encyclopaedic (almost meaningless) figure of “profits” after all manner of adjustments have been made... Put it in the most favourable light. Directors may honestly be torn between their responsibilities to shareholders (whose appetite for high dividends could become inordinate, if the full extent of reserves were disclosed) and loyalty to a company whose true interests (they may legitimately conceive) require careful husbanding of resources. In unscrupulous hands, the managerial system which was on trial at the Old Bailey, that July, could – and still can ... - lead to abuses. How “intolerable” such abuses could become, was to be illustrated soon by the revelations which followed Ivar Kreuger’s [world-wide] crash, barely nine months later.’

269 Edwards (1979, p288) adds, ‘Meanwhile, however, public confidence had to be retained and this resulted in Kylsant extending his financial ingenuity to the development of dangerous and misleading reporting practices.... He regarded accountancy as a means of deception rather than communication.’

270 At a more general level, Green & Moss (1982, p205) conclude, ‘The root of [RMSP’s] difficulties, in common with most of British industry, lay in the First World War, when the trading patterns of the previous fifty years were shattered. Although competition had been increasing before the war, it had been countered by mergers between shipping companies and by integration with shipbuilding, shipbroking, coal and other services ancillary to shipowning. The wartime growth in world tonnage – the emergence of the USA and Japan as important shipping nations, the enforced retreat of British owners from some markets, and the suspension of the conference system – made the post-war outlook bleak.’
The collapse gave impetus to changes in company law (Edwards, 1979, p289; Green & Moss, 1982, p212) and in the accounting profession (Edwards, 1979, p289-290; Green & Moss, 1982, p213). These followed a re-assessment of the secrecy/publicity dilemma. Some in the profession argued shareholders be given full disclosure – well in excess of legislative requirements – to prevent such excesses. However, it would take time to change attitudes. The profession would take action in 1942 to establish related committees (Noguchi & Edwards, 2004) and the government generally, would accept that matters of accounting were best left to accountants, as seen in the work of the 1945 Cohen Committee (Edwards, 1979, p290-295; Nobes & Parker, 1979, p199).

An interesting aside from the mainly financial-type discussion is the suggestion that the case also reflected ‘strong non-commercial considerations, usually in the shape of political or social conjectures but also in the form of official economic policy’ (Green & Moss, 1982, p214-215). Formal reporting of non-financial information was gradually being established.

4.2.2 Accounting interactions
Between 1922 and 1930, the work of the Committee on Accounting Terminology (CAT) was regularly reported in the Journal of Accountancy (see for illustrations Mucklow, 1922; 1923). Canning (1929, p9-10, p12-13, p54-55) was one who was especially critical of accounting terminology. Mucklow (1921, p479, emphasis added), the original editor, introduced CAT to readers. It was planned to work thus:

... the preparation of a preliminary list of words and expressions to be defined. This will be gathered from actual practice and from the general accounting literature.... This preliminary list being prepared, the committee proposes to select some of the expressions which are in daily use, such as: assets, liabilities...

The committee will collect the best existing definitions for each one of these expressions, and will decide upon the particular definition which appeals to the committee as a whole....

Work here had been reported in the practitioner journal since 1909. The CAT would formalise that work and provide to users authoritative criteria to resolve problems of interpretation. A series of themes may be inferred from Mucklow’s laments.271 Some issues are of an institutional type. These include,

271 Mucklow (1928, p152-153, emphasis added), was later to lament (possibly with tongue in cheek), ‘It is now over six years since, in the exuberance of comparative youthfulness, I interrupted the proceedings and suggested at the annual meeting of the American Institute of Accountants that those whose duties consist so largely in drawing, through narrative and statements, accurate descriptions of the condition of various enterprises, the matter of terminology was worthy of more consideration than it had then received. ‘The suggestion met with no opposition and, in accordance with custom, the president retaliated upon the interrupted by appointing him as chairman of the committee on terminology.... ‘The committee itself expected to compose the definitions as used in our profession, to provoke discussion thereon and also to quote from the best available authorities, whose definitions would be included as a matter of convenience, giving the names of the various authorities.... ‘The committee... members labor over their definitions, which are drawn, submitted and re-submitted, and then they let them go out to the world where they meet with silence - complete and continuous. ‘Now, no one who attempts to keep abreast of accountancy and the current literature relating to it can have failed to notice the frequent cry that the terminology of accountancy is indefinite, is uncertain and that there is no recognized authority. The cry comes from accountants, from bankers, from
(i) definitions from actual practice;
(ii) definitions from the general accounting literature;
(iii) the political cost faced by youthful exuberance for suggesting improvements in terminology used;
(iv) the political revenge of the ‘establishment’ on the young by appointing them to a newly established committee on terminology;
(v) the need for a due process for the acceptance or otherwise of the terminology;
(vi) preparation for a lack of response or criticism from practitioners and users.

All may be seen as of professional concern, being of direct concern to (and possibly controlled by) the accounting profession. The fifth may also be seen as of an infrastructure type whereby due process is found.

These themes, while important at one level of argument, were not of direct interest in the development of CoCoA. Others, however, were to Chambers. These concerned issues of the information and its quality:

(vii) whether the statements accurately described the condition of an enterprise;
(viii) whether authority was to be provided by professional use and sanction only;
(ix) whether input was to be provided by other users of the accounting.

The work done on definitions was recycled over time. Various issues arose. One was the definition of accounting. In the 1920s, even academic theorists like Paton

executives, from instructors, not only from all the four quarters of the United States, but from Canada and from Britain.

'To all such the committee has been speaking, but apparently has been casting bread upon the waters, and is likely to be buried itself before they have passed the many days required for a return or a response.

'I believe it is a fact that during all the years of its existence, one can count on the fingers of one hand all the criticisms or suggestions which have been received as a result of its efforts....

'This leads at once to our difficulty.... Is it terminologically exact to say we are speaking “over” the air or are we forced to believe that we are merely speaking “to” the air?

'The reply rests with the readers, and especially with those readers who are also writers and have lamented the past condition of terminology, but for my own part I should much like to know which expression is correct.'

272 For instance, of no direct concern would be Walton’s (1908-9, p452) suggestion that terminology problems might be resolved by an ‘accounting court’. He writes, ‘One of the unfortunate things about the profession of accountancy is the absence of any supreme tribunal which can pass on questions about which there is an honest difference of opinion, and can render a decision which will be binding upon individual practitioners...

In nothing is this lack more clearly seen than in the definitions of the terms in constant use by accountants. Where these terms originated it is often impossible to ascertain, and it is often difficult to explain the reason for their use in the particular sense that has been given to them.’ Some 100 years later, in Australia the Financial Reporting Council has become a similar ‘supreme tribunal’.

273 With hindsight, a consequence of the use of the term ‘definition’ itself leads to confusion. Leonard (1957, p271) has suggested that as many as seventy-two different types of definition exist.

274 Kohler (1929, p192) commented that ‘Lately [CAT] has been attempting to collect together the meanings of words commonly employed by the profession. Definitions, however, they do not appear to be.’
(1922, p3) argued strongly against an attempt to define 'accounting' precisely, preferring from an analysis of the broad subject – accounting – the development of the definition. Certainly, the complexity of interpersonal and organisational relationships and the multitude of transactions made the preparation of an exhaustive list of transactions to be included and their methods of inclusion in accounting impractical. The sheer length of this detailed list of rules would confirm this conclusion.

In 1931, works on terminology were published in book form and titled Accounting Terminology (Zeff, 1979, p208). The Introduction made clear any definitions were tentative and in no sense an official pronouncement of the Institute. Criticism emerged that the work was simply a collection of meanings of words commonly used by those in the profession and not definitions of the key concepts used in the information presented in balance sheets and income accounts.

The debate about which meaning – technical or vernacular or something within that range – made more evident the financial reporting expectation gap. Chambers would be later criticized for the approach he adopted of not using a technical type terminology in providing evidence to support his developed CoCoA. Chambers remained unconvinced.

Others voiced criticisms of what constituted the reality from which definitions were abstracted. For instance, in his writings, Ripley (1926) continually stressed the artificial nature of the corporate form of organization from which accounting reports were sought. He argued that while, for purposes of reasoning and analysis, a corporation could be seen as completely distinguishable from its members, this way of thinking led to various abuses of power. These included,

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275 Attempts were made to impose industry-wide regulations at that time, but it seemed to Gundelfinger (1925, p334) a futile exercise. In a section on 'The Structure of the Balance-Sheet', he writes, 'Another source of uncertainty is found in the looseness and vagueness of terminology. Much has already been accomplished toward the attainment of uniformity by the action of the Interstate Commerce Commission in prescribing a certain nomenclature in railroad accounting. But the task seems almost hopeless.'

276 Paton (1922, p3): 'It is always difficult to frame a useful definition for a broad subject. Precise definitions are likely to be inadequate at best, and are often positively misleading. It is doubtless often better to permit the entire exposition to build what definition it may make in the reader's mind than to attempt to formulate the essence of the matter in a few words. Accordingly no effort will be made to present a satisfactory characterization of accounting in a single statement.'

277 It might be, given the developments in information technology, possible to hypothesise whether this might become more probable as time elapses.

278 Stamp (1983, p121) argued, '... the questions in Chambers' survey were deliberately not couched in terms specific to corporate business. This was done not only because of his belief that this would enhance the generality of conclusions, but also because Chambers believes that personal and commercial affairs are substantially similar in style and object. Thus he believes that the responses to questions dealing with personal affairs can be used to draw valid conclusions about accounting standard setting for large public companies.'

279 Chambers et al, (1987, p1), 'It is not unreasonable to conclude that the accounting for private persons, firms, and business corporations should be similar.'
• manipulations of voting rights,
• concentration of power by the use of holding companies and related mergers and takeovers,
• disenfranchisement of some classes of shareholders, and
• holding of annual meetings in inaccessible places.

Remarkable resonance with these criticisms remains some eight decades later. Some, such as the meetings matters have been addressed; others remain.

Ripley argued the test to be used was whether a particular practice was put in place to promote the interests of stakeholders as a whole as opposed to promote simply some private interests of say management or a particular group of shareholders. He saw the safeguard against potential and actual misuse as being ‘publicity’— including published annual reports which in turn included financial statements. In discussing the quality information needed, he reintroduced an analogy hotly debated over time. Noone (1910, p241) and Bentley (1911, p50) had claimed a balance sheet as a snapshot or picture of financial condition.

Ripley (1926, p171) too claimed that the balance sheet, in disclosing the condition of the company at a point in time, provided an instantaneous photograph of that condition. The income account showed the course of affairs over a period of time and both were essential for a complete accountability.

Rather surprisingly, given his acceptance of the ‘art’ of conventional accounting rather than the ‘scientific’ approach of Chambers, Littleton (1933, p161) also used a photographic film analogy for movements over time. (Here it is of a toboggan on a slide). However, he does suggest that a ‘cutting and editing and reassembly’ is required – more along the line of argument of May (1936, p49ff), who was at odds with such a description of a balance sheet. Instead he argued that the general public must understand that a balance sheet should be viewed as an instantaneous picture only in part, as some parts were historical and others purely conventional.

280 These days it would be termed ‘disclosure’ or ‘transparency’.

281 Noone (1910, p241), ‘It is the function of a balance sheet to disclose the true financial condition of a business enterprise as of a particular moment of time. It should be a snapshot.’

282 Bentley (1911, p50), ‘A balance sheet is a statement of the assets, liabilities and net worth of a business at a particular time ... a picture of the financial condition of a business...’

283 These references were found via Chambers (1995). Perhaps rather surprisingly, Garnsey (1928, p36-37) would use the same analogy.

284 Merino & Coe (1978, p66), ‘The profession had been genuinely shocked, if not horrified, by Ripley’s assertion in the twenties that the “balance sheet is an instantaneous photograph of the condition of a company”.’ Rather it was suggested that the use of opinion and judgment (Montgomery, 1927, p253) made the claim absurd.

285 In the 1950s, a spirited debate occurred between Littleton (1956) and Chambers (1957) on this matter. Further discussion is found in Staunton (1979, p111 & 1982, p10-11) and the Collection (USA P202, Box 24, #8371).
The phrase ‘conventional’ – as it literally suggests – leads to the inference that the conduct of one person or body in regards to another follows developed and set conventions which are known to all. Thus in business, as argued by businessmen like JP earlier (3.2), qualities like ‘character’ and the like were paramount. May followed a similar line of reasoning (1936, p12), ‘... the accountant must be a man of high character ...’ Reference (p15 and p23) is made to the ‘high-minded accountant.’

Ripley would have no part of such views, especially the ‘limitations of accounts’ mantra. Instead, he maintained that it was ridiculous for non-accountants to be advised that an official income account did not at all provide a ‘clear picture’ of annual earnings nor did the balance sheet disclose the ‘true value’ of the non-current assets of the corporation. He criticized,

- accumulation of undisclosed resources in secret reserves,
- overloading of operating expenses with contingencies which had an offsetting effect on either assets or liabilities,
- manipulation of depreciation,
- manipulation of the monetary amounts of inventory,
- manipulation of goodwill, and
- other conservative reporting practices.

To some, these 1920s criticisms might seem rather modern (Briloff, 1972, 1976, 1982; Chambers, 1973; Clarke et al, 1997, 2003). In any event, the antecedents are clear.

Debate continued that a position statement differed from the phrase used in conventional accounting – the balance sheet. May (1943, p14), was of course aware of the difference. His preferred process led to a conventional accounting balance sheet. An alternative, however, would produce a financial position statement. The

286 In a game context (the card game contract bridge comes to mind) all players are aware of the conventions and act within their spirit.

287 May (1937, p15) would continue to comment on issues like etiquette influencing formal accounting matters, referring to his ‘being retained as a consultant by the body which, thanks very largely to the efforts of my good friend, Mr. Foxsey, has come to be recognized as unquestionably the greatest non-professional authority on the etiquette of financial accounting, the New York Stock Exchange.’

288 May (1943, p14), ‘When concepts of income come to be considered, one will be presented which views income as an increase in net worth, and another, which regards it as the gain from the use of capital and labor. The first of these contemplates a process of enumeration and substraction; the second an analytical process. In applying the first concept, income is measured from comparative balance sheets, and the income account merely supplements the determination by an analysis of its origin. Where the second concept is used, the income account discloses the amount of income, and the balance sheet shows what has become of it.’
debates and related tensions continued, with Fitch (1923, p1-2) and Bennett (1928, p428) arguing for the alternative.

Couchman (1928) also discussed various limitations of the balance sheet. Later he (1929, p25-26) argued that many purposes existed for which a balance sheet was prepared. These purposes would govern the treatments and classifications displayed. Grantors of credit sought a balance sheet prepared on the basis of going-concern value where the organization is presumed to continue in subsequent periods in the same general way as in the past. This balance sheet does not display a value based on forced realization or the expected realization in the normal course of business. Tensions which would be recycled over time included:

1. What is the function of a balance sheet?
2. How should elements be classified?
3. How should elements be valued?
4. Were past, present and future events being intermingled?

History has revealed that May’s approach based on conventions gained prominence. Debate continued on where emphasis should be placed, it being argued that undue significance was given to the balance sheet and too little to the surplus and income account. It was argued the balance sheet was of secondary importance to a stockholder mainly interested in earning power and dividend probabilities. Values from both a producing and a security viewpoint were seen to be required (Peloubet, 1929, p338).

But the criticisms continued. With pressure mounting for some federal regulation, attempts were made for reform by the AIA and the NYSE (Editorial, 1930, p242; Chatov, 1975, p19). Of special concern was that different corporations could use a variety of accounting practices (May, 1943, p41) to reflect similar transactions in their reporting. Hoxsey (1930) questioned whether the conventions underlying accounting had kept up with changes. As a result, the Special Committee on Co-operation with Stock Exchanges was appointed with May as chair (Zeff, 1979, p208-209). A search for comparability was prominent.

289 Fitch (1923, p1-2), 'The balance-sheet ... sets forth the status of the company's financial condition at stated dates, and the profit-and-loss statement ... accounts for the changes in financial condition between two balance sheet dates ....'

290 Bennett (1928, p428), 'If a balance-sheet is truly a statement of condition as of a specific date, and is certified as such, it seems reasonable to assume that this should refer to the whole truth rather than perhaps, as seems usual, to only a half truth. It is believed that an accountant should be censured as severely - even legally punished - for being found guilty of over-conservatism as for being found guilty of over-optimism or carelessness.' He went on to refer to (1) multiple balance-sheets, (2) all-purpose balance-sheet and (3) use of footnotes versus actual entries in the statement.

291 Carey (1969, p38) writes, 'Following the Hoxsey speech in 1930 the Institute also hastily created a special committee on accounting procedure to consider "a number of technical questions that had been raised."... In the light of hindsight, it seems clear that fragmented efforts to solve difficult problems through different committees were doomed to failure. There was no agreement as yet on a basic philosophy - a conceptual framework within which each specific problem could be dealt with consistently.' This is also discussed in some depth by Hawkins (1962, p415-425) who concluded the action was too little, too late. Perhaps he might have added 'uncoordinated'.
The May Committee provided the foundations on which later work on accounting principles was based. Professional accounting bodies became involved in the development of what was to be termed ‘accepted accounting principles’. May’s Committee reported in 1932. Its findings were:

- a balance sheet is not a statement of current factual data,
- the primacy of the income calculation is emphasized,
- principles of accounting are interchangeable with the practices and methods used by accountants,
- corporations had the right to select detailed methods of accounting deemed by them to be best adapted to the requirements of their business with the proviso that methods of accounting included conservatism, the idea of a going concern and consistent use of those methods over time, and
- an overriding theme that the public was to be educated to accept these ideas as well as the nature of resulting accounting reports and their limitations.

Much trust was required from other stakeholders to be placed on the ‘professional status’ of the accountant. May (1936, p115) was able to claim,

*Most investors realize today that balance sheets and income statements are largely the reflection of individual judgments, and that their value is therefore to a large extent dependent on the competence and honesty of the persons exercising the necessary judgment.*

One might easily agree with the statement if judgments were based on solid foundations of accounting – one (like CoCoA as demonstrated below) derived within commercial settings. However, the foundations were to some of sand.

Questions of terminology continued to be debated. An Editorial (1928b, p34) lamented the lack of standard definitions in accounting. It also cautioned of potential difficulties in the use of vernacular meanings, though where possible it recommended technical meanings should be adapted to common use. Another Editorial (1930a, p6-7) questioned the meaning of terms found in financial statements to the ordinary reader. Blame was placed on accountants who controlled the method of reporting but failed to realize that their technical knowledge was peculiar to accountants, affecting a myriad of stakeholders.

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292 The Report is produced in various publications, including May (1943, p72-85).

293 This quotation too appears in various publications, including the May Committee report (May, 1943, p75-76).

294 Editorial (1928b, p34), ‘The whole question of terminology is of such vital importance to the profession at large that it is probably quite unnecessary to emphasize it. No one who has been engaged in accounting is ignorant of the fact that there is no standard definition of many of the accounting terms which are in common use ... The best definition does not necessarily imply the most common interpretation, although in many cases it is wise be adapt technique to custom rather than to attempt to make custom conform to technical ideas.’
All professions of course have their technical jargon for inter-professional interface but if interface is with a non-professional, a common language for communication is required. Otherwise, chaos is found.

Input into various debates was also provided by academics like Canning. He was most intrigued by the theory (or lack thereof) underlying accounting. He (1929, p3) criticized the growing tendency to discuss formats of reports as though they were end-products in their own right. To him, they were instead the basis on which decisions of policy were made. He also took issue with text books of the time, finding them largely manuals of procedure whereas systematic analysis would seem a better approach. He (p45-46) did caution, however, that the texts seemed to differ from practice.

As noted by Chambers (1979) and Zeff (2000), in discussing ‘income’ Canning (Ch 8, p143 et seq) relied on Fisher’s treatise (1906) met in 3.2.2. This concept of economic income is seen as something absolutely real even though dealing with future events. Here a balance sheet shows the businessmen’s future prospects. Future returns are known and discounted to present values. Notably, Canning (p91) did use the words ‘objective’ and ‘subjective’ when talking about ‘income’ as seen by the accountant and the economist.

Some of Canning’s ideas were similar to those of Chambers. Two features which Chambers admired were the use of rigorous definitions and the specification of rules of measurement and summation. Others were contrary to those underlying CoCoA,
especially the past and present emphasis of Chambers.300 He would argue that while any claim an asset is ‘a storage of service’ or ‘a collection of future benefits’ may explain why a person buys an asset, it does not explain what is bought. Chambers’ definition of an asset would also emphasise the means idea within the context of a presentation of contemporary financial position. Canning’s contribution to the literature highlighted implicitly key differences between accounting and economics. Arguably, the latter is more to do with business behaviour while the former to Chambers provided information for use in that behaviour.301

At the application level, Littleton (1933, p160) argued that profit calculation was no longer a simple computation. He gave two reasons – it was a complex calculation often suited to management’s purposes and no longer did ‘value exchanges’ dominant, as other effects (like deferred debits and credits) could be incorporated.

May (1936, p405-406) reviewed Canning’s work, questioning Canning’s stated relationship between accounting and economics and argued that accounting was ‘a tool of business’. May was especially critical of ‘physic income’; to him, income was ‘essentially a money concept’. Elsewhere he would criticise Canning for what May saw as misconceptions of the function of accounting (May, 1936, p305-306), a point he would make in deflecting criticism of accounting after the Great Crash.

Dillon (1977, p5) constructed a profile of accounting in the USA in the 1920s. From his analysis he drew conclusions on the role of accounting in the stock market crash of 1929, including that consequences from accounting were not extensive. Others were not so sure.302

300 Chambers (1979, p774), ‘That search [for better standards and theory] has been befogged by confusion of the different but complementary roles of past information, present facts, and future prospects in the decision-making process. The linkage between accounting and economics cannot be properly established unless those roles are specified. Past values or prices and presently observed values or prices are necessary for the determination of past results and present position; presently observed values or prices and calculated net present values of future alternatives are necessary for the exploration of the feasibility and desirability of future alternatives. None of the three kinds of “values” is a substitute for the other. Had the distinct functions of all three been identified by Canning, as a prelude to “the economics of accountancy,” there may have been, by now, a more disciplined attack on that part of accounting which concerns itself with statements of past results and present position from time to time.’

301 Canning (1929, p20) did comment, ‘But to include in the statements, e.g., the balance sheet, mere expectancies, would be to introduce items the value of which is highly speculative among items the value of which can be measured with much greater reliability.’

302 See de Bedts (1964, p22), ‘During the months leading up to the selection of a new national administration the average newspaper reader was thus subjected to a continual front-page drumfire of financial corruption and downfall. The abdication of Samuel Insull from his utilities empire, and the subsequent realization that literally no one was able to put this financial Humpty Dumpty together again, was but one of the many shocks. Bankruptcy proceedings against Kreuger and Toll, the huge holding company for the Ivar Kreuger interests, revealed that Kreuger’s recent suicide had left personal debts and liabilities totalling an unprecedented $168 million. After eight years of fraudulent bookkeeping …’ Consider events post-2001 – Enron’s unexpected demise and the eventual revelations of accounting irregularities, fraud, alliances with institutions – in some ways it was a rerun of the 1920s and 1930s.
Carey (1969, p38) did suggest criticism was perceived of accounting (and therefore of the profession) after the stock market crash of 1929. A reaction was to introduce the 'red flag' of the limiting phrase 'accepted accounting principles'. Implicitly a consequence of the work of May and his various committees, the phase had its genesis in the 1930s. The search for accounting principles tended to cover how they were developed. While institutional issues of an infrastructure type are undoubtedly important, they provide just one part of the total picture. Arguably, the quality or serviceability of the information produced was in question.

4.2.3 Reporting of liabilities
Discussion of liabilities still tended to begin with identifying known liabilities at balance date. Under the UK Companies Act, 1929, reports were for the first time required to specify details of liabilities included in the balance sheet (Hein, 1978, p233; Edey, 1979, p228; Edwards, 1980, p51). As well, any contingent liabilities were to be included as a note. Known liabilities were subdivided into current and long-dated indebtedness. This was in turn subdivided into secured and non-secured.

The use of credit via an instalment plan to buy over a longer term (especially motor vehicles) helped stoke the bull market and provided reporting tensions for liabilities. Some complained the average balance sheet ignored a number of important liabilities like leases, service agreements and contracts entered into for future delivery, while liabilities sometimes included substantial sums which had no factual basis (Fincham, 1928, p56). However, the view continued to be held that treatment of liabilities was generally of little concern. Compared with the valuation of assets, little was written on the valuation of liabilities in this or earlier periods. This was despite instances which included the over-valuation of liabilities for taxation, known contingencies and possible future contingencies (Garnsey, 1928, p46-47).

However, Canning (1929, p47) included discussion of liabilities at a theoretical level, suggesting their analysis as a distinct element. To improve terminology in the area, he (p49) emphasized the notion of identity. Implicitly, assets and liabilities were seen to be related inter-entities and intra-entity. However, he did not explicitly state that definition and measurement of each class needed to be the same.

Canning (p55-56) was arguably before his time when proposing the following definition:

A liability is a service, valuable in money, which a proprietor is under an existing legal (or equitable) duty to render to a second person (or set of persons) and which is not unconditionally an agreed set-off to its full amount against specific

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303 Carey (1969, p38), 'The financial community was in a state of shock. Thirty billion dollars of quoted value of securities vanished in less than a month. Banks failed and, in some states, were closed. Financial paralysis gripped the country. Public reaction was bitter, and a critical review of the processes of the financial market, including financial reporting practices, became an obvious political necessity.'

304 Canning (1929, p47), 'Failure to see the identity, it is believed, lies at the root of much that is confusing in the treatment of liabilities, the third term of the equation. A liability in its most general sense implies a relation between persons. One who is obliged to do something adverse to his own interest and beneficial to another's has a liability to that person.'
services of equal or greater money value due from this second person to the proprietor.

The reference to 'legal or equitable duty' would receive various interpretations, leading to diverse practices which he (p58) was to question.\(^{305}\)

Arguably, Canning was guided by legal considerations, as he (p63) made the following comment: All liabilities in the accounting sense are debts in the legal sense, but the converse is not true. This argument literally suggests that 'accounting liabilities' are a subset of 'legal debts', a position inconsistent with definitions reached in later times. Canning also argued that obligations which are equally proportionally unperformed by both parties were not liabilities in accounting.\(^{306}\)

Controversy surrounding bonds continued. Rock (1921, p36) for example, referred to '...the whole problem of raising and acquiring capital, redemption of indebtedness and replacement of capital represented thereby' in a paper on one particular source of possible problems, the redemption of bonded or similar indebtedness. Accounting Questions (1930; 1931) continued to consider various issues, but to little avail as regards underlying reasoning.

Discussion of a lack of disclosure of contingent liabilities also continued (Marsh, 1922, p23-24),\(^{307}\) though illustrations of items then included in financial statements were provided (Meinhardt, 1922, p191).\(^{308}\) Beckman (1923, p343-344) criticised the lack of adherence 'to the strict and exacting requirements of accuracy' in the presentation of various contingencies in financial statements. Gundelfinger (1924, p423) agreed, finding various possible treatments of a contingent liability. Whitworth (1926, p182-183) identified similar applications within the automobile industry, arguing for more uniformity.

Chamberlain (1926, p423-424) supported the creation of actual accounts for contingencies, but argued these were part of owners' equity. Narlian (1928, p86)

\(^{305}\) Canning (p54-55) had pointed out that the term was 'one of the oldest terms in use in writings in English on the subject. Whatever may have been the grounds for its early adoption, it can now be said that the term is seriously confusing and misleading.'

\(^{306}\) Henderson (1974, p169 & 175) suggests this is the first use of the expression in the accounting literature. Myers (1962, p5) makes a similar point in the context of leases. Related issues would to continue to be discussed (Carpenter & Wojdak, 1971).

\(^{307}\) Marsh (1922, p23-24), 'An item that is too often overlooked is a firm's contingent liabilities. These may consist of its endorsements on paper discounted, guarantees of accounts, forward contracts for material and any other liability that may be incurred and does not show on the face of the statement. 'During the past year shrinkages in values of commodities have occurred that have placed thoroughly solvent concerns in a shaky position because of their inability satisfactorily to adjust contracts which existed before the shrinkage. Such contracts have created contingent liabilities that rise up at the most unexpected times to "smite" the merchant or manufacturer with a most embarrassing demand for payment.'

\(^{308}\) Meinhardt (1922, p191) listed Bonds, Current Liabilities (Bills payable, Trade accounts payable, Unclaimed sacks, Payroll accrued, Bond interest accrued, Taxes accrued, Royalties accrued) and Reserves (Depreciation of buildings, Depreciation of machinery, Depletion of quarry lands, Contingencies, Doubtful accounts, Redemption of sacks (unearned profit)).
analysed various schemes for instalment financing of automobiles and their effects on reports of a dealer. Of part of Narlian’s argument, an Editorial (1928c, p197-198) reported that several readers believed they contained ‘heresy’. Debate was on ‘proper accounting procedure’ and the source from which it is developed. Some argued legal opinions played no part in disclosure of contingent liabilities. The only reason for non-disclosure was it being of an insignificant magnitude.  

Narlian (1928, p94) suggested terminology to classify selected credit balances into ‘impure’ and ‘true’ reserves. Saxe (1929, p38) disagreed with Narlian’s reasoning, suggesting contingent liabilities be attached at the foot of a pro forma Financial Statement. Contingent liabilities were bases for discussion in Accounting Questions (1930a, p313-314; 1930b, p392-393; 1931a, p232; 1932, p313-314). Conflicting answers were provided, leaving it to the reader to consider implications for a definition of ‘liabilities’.

As regards fundamental questions of definition, Kohler (1929, p192) warned of a lack of definitions in accounting. A formal relationship remained elusive among various elements in a set context. Later, Chambers (1966a, p128-131) would develop a set of general rules of the double-entry recording system. Another example would be the development by Paton (1922, p37-38) of a schemata of the sources from which an entity has financed assets at a particular point in time. However, difficulties in treating deferred credits continued. Terminology Department (1923, p142) supported their inclusion on a balance sheet, as did Gundelfinger (1924, p422).

4.3 Franklin Roosevelt and the new deal
The aftermath of the Great Crash included a major economic depression (Galbraith, 1971; Chatov, 1975, p22). Attacks on big business by various groups (liberals, progressives, socialists and communists) grew stronger in the chaos. Management had few, but inadequate, answers to the critics who demanded social and corporate reform. Protection was sought from corporate abuses not only for investors and consumers but also for employees and small businesspeople.

In the 1932 campaigns, Hoover’s policies included self-regulation, but with the proviso that if found lacking, new legislation to prevent abuses would follow. FDR’s

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309 Sperry (1928, p122) suggested, ‘Contingent liabilities are even more troublesome to ascertain and state correctly from the point of view of the accountant and the banker. The solution to the problem is far often found in the complete absence of any statement about such items.’

310 Terminology Department (1923, p142), ‘Balance Sheet: A statement of the financial position of an undertaking at a specified date, prepared from the books kept by double entry, showing on the one side the assets and, on the other, the liabilities and accountabilities (for proprietorship or trust funds) and the surplus or deficit is shown on the one side or the other as the case may be. The asset side may include deferred debit items and the liability side may include deferred credit items and reserves (except those applied in reduction of assets).’

311 Hawkins (1962, p385) commented, ‘As the “new era of prosperity” became the “great depression”, the attack on big business and its attendant demand for greater corporate publicity was reopened with new vigor. The misery of the depression, and the financial chicanery revealed at the hearings on stock exchange practices conducted by the Senate Committee on Banking and Currency during 1932 and 1933, led to a widespread public desire for economic and social reform; the critics knew what reforms were necessary and the public were again sympathetic to the critics’ proposals.’
policies included the protection of the investing public by the requirement of ‘truth in securities’ dealings based on ‘true information’ being filed with government. General and vague statements were to be made clear by FDR if and when elected (Sobel, 1965, p284-285).\(^{312}\) In 1932 FDR was elected President.

Earlier in 1932, a Senate Committee inquiry was set up, paradoxically\(^ {313}\) by the Republican controlled house. Ironically, the investigation’s findings were not as expected.\(^ {314}\) The investigation found fraud, duplicity\(^ {315}\) and other excesses (involving the use of holding companies among the electricity, gas and water utilities)\(^ {316}\) The scene was set for action to reform and control by legislation. The philosophy based on *caveat emptor*, used so successfully by operators on Wall Street in the past and which had underpinned UK finance during the 19\(^ {th}\) and early part of the 20\(^ {th}\) Century, was seriously challenged (Hawkins, 1962, p388-395; Sobel, 1965, p286; Chatov, 1975, p30-31).

Ripley gave testimony but now had further and more recent abuses to support his 1920s argument for compulsory publicity. Using the biblical anecdote of orphans and widows\(^ {317}\) who required protection, he argued that corporate financial reports for industrial concerns required legislation as found in other areas like railroads, a suggestion made over time (Bentley, 1912, 1912a). Instead of the system based on secrecy previously used, a trustee type relationship was suggested as the basis for reforms with legal backing. Arguably, the link with the UK regulation was now at an apex (Hawkins, 1962, p394-396, p409; Chatov, 1975, p33-34).

Issues raised regarding accounting were considered by FDR’s reformers. Their views were incorporated into the Securities Act of 1933 (which gave sweeping powers to the FTC), the later Securities and Exchange Act of 1934 (which transferred those FTC powers to the new Securities and Exchange Commission) and the Tennessee Valley Authority Act. Here, emphasis is on the Securities and Exchange Act.

The establishment of the SEC and its effects have been the subject of numerous articles\(^ {318}\) and books over the years. Chatov (1975) provides one of the more

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\(^{312}\) Recourse to ‘truth’ would be relied on again in the new millennium reforms of the Sarbanes-Oxley Act.

\(^{313}\) Some Republicans were expecting Democrat supporters (including Kennedy of whom more is discussed later) to use bear raid tactics to embarrass Hoover.

\(^{314}\) As has been discovered under UK and Australian Royal Commissions over time, they are seen as politically dangerous as they tend to have unforeseen findings.

\(^{315}\) One finding was that a marketing person on behalf of some groups had sent cheques to financial analysts and journalists of leading papers for favourable comments (Sobel, 1965, p285-286).

\(^{316}\) Certainly the findings from the investigations (introduced earlier in 4.4) into the Kreuger & Toll case (Vallance, 1955, p155-166; Hawkins, 1962, p397-398) and the Insull case (Vallance, 1955, p167-179; Hawkins, 1962, p398-400) supported the case for major reform.

\(^{317}\) *The Holy Bible* (1984, James 1,27).

\(^{318}\) Benston (1976, p483), ‘Though the U.S. Federal Securities Acts were modelled after the U.K. Companies Acts (which predated them by almost a century), they are administrated quite differently.’
controversial instances. Whilst Zeff (1976) in a review wrote of his major misgivings of the argument, research methods and conclusions reached, Chatov does provide some challenging propositions which attained credibility after unexpected collapses and other financial market practices revealed in various investigations in the 1970s and beyond – extending into the new millennium.

In a less controversial overview, de Bedts, (1964, pviii) found the SEC not anti-business but a social control. Tensions were certainly heightened by the emergence of the SEC. However, as is often the case, some debates were at cross purposes. The fight of the reformers against fraud and corruption was side-tracked into being against ‘bigness’. The attempt of the reformers to revitalise capitalism was side-tracked, being seen by some as seeking its destruction (Sobel, 1965, p298-299).

FDR sought to re-establish the idea that those who managed corporations using ‘other people’s money’ were to act as trustees. The onus of providing the whole truth of affairs of those corporations would be placed on that management. This conflicted with the caveat emptor principle underlying interrelationships found on Wall Street. While in earlier times such a suggestion was seen as a flagrant interference of government in business, now it was accepted as a minimal requirement (Sobel, 1965, p293-294).

The views of the reformers who sought legislation to protect investors were given support by evidence and analyses in Berle and Means (1932). Berle, a professor of law, became a member of Roosevelt’s ‘brain trust’ assembled to advise the President on how recovery from the depression would best be carried out and how a recurrence might be prevented.

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319 de Bedts, (1964, pviii, emphasis added), ‘as a vital part of the New Deal’s pragmatic experimental evolution, with its Progressivism more antifraud and anticorruption than antibigness. The conclusion was reached that the SEC furnished an outstanding demonstration of the New Deal’s intent to revitalize American capitalism rather than seek its destruction. This successfully consolidated agency brought about both acceptance and expansion of some of the New Deal’s most enduring reforms, replacing improper financial practices with standards of ethical conduct. Not only did this regulatory agency furnish the answer to the protection of the investor, but through the SEC the New Deal accomplished the necessary democratization and social control of the world of finance.’

320 Berle (1954, p169) would later recall a debate with the late Professor Dodd, of Harvard Law School, who argued that corporate powers were held in trust for the entire community. Berle had argued these powers were held in trust for shareholders. He concluded that (at least for the time being) Dodd’s contention had won. The essence of this debate is also discussed by Hawkins (1962, p409-414). It continues to present times as the debates like that of whether or not philanthropic actions of companies are legitimate uses of corporate funds.

321 Not all were impressed with the ‘brain trust’ employed by Roosevelt in the early days of the depression which was to split in all directions on doctrinal points. Arnold (1937, p117) commented, ‘The brain trust fell into disrepute and became a political liability rather than an asset.... The thinking men of the country were all busy thinking and the more they thought, the more mixed up they became. No one could fit the social organization which he saw before him into the organization of his dreams.’ Sobel (1965, p289) suggested many on Wall Street ‘feared some of the “bright young men” who surrounded the President.’

322 Arguably, Berle and Means (1932) was a blueprint for the Securities Acts. The authors gave credit to Ripley in the preface in recognition of his pioneering work in the area (Hawkins, 1962, p386; Carey, 1969, p39).
From an analysis of the concentration of economic power in a relatively small number of large corporations in the period 1915-1930, Berle and Means (1932, p304) had shown how the dispersion of stock ownership enabled management to control corporate reporting, finances and the distribution of earnings. They criticized the inadequacy of information given to investors and, as met earlier, pointed out methods of accounting manipulation to show abnormal profits.

May's suggested method to overcome this problem was the use of capable accountants of a high degree of integrity. However, Berle and Means (p310), since rules of accounting were not yet even partially recognized as rules of law, suggested the lack of agreement among accountants was a key reason for the failure of the law to recognize accounting standards. Accountants lacked a unifying theory. However, they certainly saw the potential of accounting reports and their external audit by a professional accountant as key control devices. Their 'list' of disagreements (p310-311) among accountants (which would later be described as 'creative' accounting practices) certainly has a modern look.

The reformers' views created tensions, especially among business leaders in general and accountants in particular. As might be expected, attacks on reforming legislation came from various areas. Opposition from the financial community in general and specialists of the Exchange in particular led to the SEC having no jurisdiction over the credit element found in any speculative market. Instead, control was left with the FRB (Sobel, 1965, p297). The electricity utilities and their sector waged a political and public relations campaign against the TVA (and the related Public Utility Holding Company Act of 1935). This effort failed in part because of the widespread distrust of big business and from the lack of willing lobbyists.

323 De Bedts (1964, p46-47) comments, 'The accumulation of the evidence of arrogant misuse of depositors' funds, of blatant financial privilege for the favored few, and the complete absence of any regard for the fiduciary responsibility that financial leaders yet claimed as their chief distinction were anger-provoking material common to all. No one could attend the Pecora Investigation, nor could the public follow the hearings in the press, without being convinced beyond all doubt that financial leaders and spokesmen thought of themselves as distinct from the rest of the nation. Their sovereign command of finance was, quite clearly, being invaded by an unduly inquisitive and rather insubordinate Federal government.... The investment bankers who pleaded before Congressional committees for some amelioration of the bill's restrictions found they had been damned out of the mouths of their own fellows.'

324 de Bedts (1964, p51, Footnote reference omitted) comments, 'Adolf A. Berle, Jr., writing on the subject of high finance several months after the Securities Act was passed, indicated a disappointment that was fundamentally directed at the financial system rather than specific shortcomings of the bill itself. To Berle, one of the original Brain Trusters, investment bankers still dominated the financial scene to an unhealthy degree, and the control of new corporate security issues that had slipped from their grasp in the 1920's had lately been regained through devices such as the investment trust and the pyramid holding company. The Securities Act as the national equivalent of the state blue-sky laws thus was inadequate, Berle thought, because it excluded only fraudulent finance. The problem of power arising from financial control exercised by investment bankers was not solved, since the fundamentals remained unchanged even though the Securities Act served to clean up many financial practices and ethics.'

325 Instead of being seen as political lobbies, various associations were formed as 'research institutes', a practice continued to present times.
FDR’s selection of Kennedy as the first Chairman of the SEC surprised many (Previts & Merino, 1998, p274). However, he ended the so-called ‘strike of capital’ (Chatov, 1975, p74-75) by opponents although during his tenure several prosecutions and key indictments resulted. By 1936, to some the SEC was seen as a dominant force on Wall Street and the NYSE no longer a closed private club (Sobel, 1968, p395). Others, like Chatov (1975, p113), were less sure.

The accounting profession, lacking policy positions, strategies and constructive proposals for dealing with the new federal legislation, had to react to the securities and related acts. Carey (1969, p43) writes that despite all the warning signs, AIA was not prepared for legislation introduced in 1933. Indeed, it surprised the profession which then engaged legal counsel in Washington. AIA reacted by creating a committee to deal with the new legislation which would become pivotal for potential reform. Indeed, Chatov (1975, p39) suggests it went on to capture the standard-setting process and thwart government intervention.

Arguably, AIA was in crisis-management mode. It acted as a pressure group more concerned with implications for its members, especially those in practice, regarding

- degree of liability for negligence faced by accountants, and
- prescription of form and content of financial statements.

In 1934, this liability was modified (Edwards, 1960, p157) and administration passed to the SEC. However, the potential of financial statements prescribed by a government body created tensions among accountants.

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326 Carey (p43) writes, ‘On this and on many other occasions the profession was fortunate in having the guidance of Judge Covington. He was a highly respected citizen of the nation’s capital. He was an able lawyer, of unimpeachable integrity. He also had access to members of Congress and of the executive branch.

‘Perhaps at Judge Covington’s advice, the Institute did not appear formally at the hearings on the securities legislation. After all, the profession’s record in developing standards of financial reporting was not impressive. Even the basic philosophy outlined in the stock exchange correspondence was not yet available for public reference. If official representatives of the Institute had testified at hearings, they might have been subjected to hostile questioning. This could have resulted in further adverse publicity, and possibly even more punitive legislation than that proposed.’

327 Zeff (1972, p126-127) traces developments leading up to the establishment of CAP. Again AIA appointed George O May as chairman.

328 Edwards (1960, p156) writes, ‘The passage [in 1933] of the Securities Act somewhat disturbed the profession both because of what the public accountants considered an unreasonable degree of liability imposed upon them, and because it was feared that the enormous power conferred originally on the Federal Trade Commission, which included the power to prescribe forms of financial statements, might not be wisely administered.’

329 This argument is consistent with Carey’s (1969, p45) writing of a memorandum submitted by the AIA when the 1934 Act was under consideration by Congress. In the memorandum, objection was taken to the liability provisions of the proposed legislation. As well, the proposal that a quarterly report be certified by independent public accountants was questioned. The Institute also challenged the power given to the SEC to prescribe uniform accounting for industry. It was pointed out (rather facetiously perhaps) that attempted uniformity in the accounting of public utilities and railroads had not resulted in more dependable financial statements in those industries. Rather, greater advances in accounting had occurred in unregulated companies.
Reaction to some issues might be seen as too profession-friendly. These included matters like the public liability of the accountant, other stakeholders expecting too much of accounting reports and the related audit process and the ability of government via its Commission to prescribe uniform practices. What stakeholders other than accountants expected of accounting reports continued to be recycled.

The profession was arguably fortunate as the SEC too faced institutional pressures. Carey (1969, p45) writes of the preoccupation of the early commissioners and administrators of the two acts with

- organizational issues,
- the rules, forms and procedures to be developed,
- prosecution of flagrant violators, and
- public acceptance of the new environment.

Although some argued the SEC should exercise its authority to prescribe accounting principles and methods, it finally decided not to do so, partly perhaps due to the persuasiveness of AIA representatives led by May (May, 1936, p63-66 et seq; Carey, 1969, p46). While it is possible to debate the extent of the AIA’s influence, it seems a greater influence was the philosophy adopted by the early SEC Commissioners. As well, there were the previous experiences of Healy (recall Footnote 212) who cautioned of potential consequences from bureaucratic oversight and overload. This outcome is consistent with Carey’s (1969, p46) conclusion that the SEC adopted a policy of gradual improvement in disclosure practices. The initiative to propose and develop accounting standards was left to the accounting profession. The issue of the rate of improvement (was a ‘gradual’ rate sufficient?) would lead to tensions among groups. As will be argued in Chapter 7, it was an issue faced by Chambers in his role in the CF project and its relationship with CoCoA.

330 The matter of a government body prescribing accounting statements continued to be raised in succeeding decades. (See Editorial, 1946a, p361; May (1946); Editorial, 1947, p456; Carroll, 1951, p11; Trumbull, 1953, p472; Wertz, 1953, p169; Merino & Neimark (1982), to name a few).

331 de Bedts (1964, p88) writes of the five appointments made to the new SEC. ‘Four of them - Ferdinand Pecora, the affable and relentless quizmaster of the Senate investigation, and Landis, Mathews, and Judge Healy of the FTC - were more or less expected, but the one chosen for the fifth position created considerable surprise and some chagrin. The name of Joseph P. Kennedy, and his appointment to the top five-year term, brought widely differing reactions.’

332 de Bedts (1964, p100) concludes, ‘Commissioner Landis’ speeches and articles in the early days of the SEC demonstrated the development of his ideas on the responsibilities of American banking and finance. Continually pleading the benefits of a supervised self-regulation, Landis gradually shaped his distinctive philosophy of the Federal administrative agency and the administrative process. ... Neither the financial world nor the SEC dared fail, Landis warned. The nation was so deeply determined that conditions of the late twenties not be allowed to repeat themselves....’

333 de Bedts (1964, p54) writes, ‘Judge Healy’s FTC experience thereby played an important part in preventing any rigidity of administrative fiat. Zealous and misguided attempts to legislate rules and regulations rather than let a regulatory body sublegislate the policy of Congress might have led to wrecking such a structure by an equally zealous reaction later. The injunctive process as it was finally written gave to the legislation a directness and a strength of action that was to set the tone for succeeding measures’.

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Tensions grew for accountants with the discovery of another major fraud – the McKesson & Robbins case (Previts & Merino, 1998, p294-296). Writers have referred to this in various contexts. Brown (1941, p527) suggested that the case was one which excited public interest. Three decades later, Cooper and Flory (1976) would compare the case with that of Equity Funding fraud (Andrews, 1973; Dean and Wolnizer, 1978), pointing out differences, similarities and lessons for auditors. Comprehensive discussions of the particulars of the case are found in Keats (1964) and Staunton (1977).

However, as regards this study, arguably the best summary is MacNeal’s (1939/1962, p57). While sympathetic to and defensive of the profession and accountants, he concluded,

*But so far as the public was concerned, McKesson and Robbins was no Kreuger case. The public had been so enchanted by the role of the match king as an international swindler, and so agog at all the ramifications, that it didn’t get around to placing blame. But there was no public enchantment about McKesson and Robbins. Coster had none of Kreuger’s glamor; in the public eye he was a dirty little crook who had got away with a gigantic swindle. This time Wall Street was not involved in the public resentment that welled up. The accountants were. Millions of dollars’ worth of drugs that could be weighed and measured and felt, turned out to be fiction. For the first time, the great uninitiated public asked questions it had never asked before. What occupied the time of the public accountants who got fat sums for auditing? What was an audit for if it didn’t protect the investor? And what, for that matter, was public accounting?*

Perhaps accountants and their profession were spared having to answer the questions posed by MacNeal as WWII intervened and the times would demonstrate that the great corporations and their [primarily internal] accounting requirements were indispensable to the military effort. Little legislation of concern to those in the accounting profession followed. Indeed, the fourth SEC Commissioner (Frank from 1940) would argue cooperation among groups was far better than competition in areas like standard setting. Fortuitously, war orders from UK and Europe would help the USA economy recover (Sobel, 1965, p308-310).

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334 Brown (1941, p527), ‘These cases have the effect of focusing the public interest on the Auditing profession, and it is only at these particular times that any real stock of our responsibilities and liabilities is taken. At these times Auditing procedure becomes news; Commissions are set up to inquire into auditing procedure and practice generally. Observations are made and the attention of the investing public is drawn to the extent and scope of the auditors’ responsibilities.’

335 MacNeal’s (1939/1962, p57), ‘In December 1938 the fantastic manipulation ... was disclosed. The profession was chagrined; another large fraud had not been detected until it was too late. Accountants generally were critical of Price, Waterhouse and Company, the fine old firm through whose fingers the criminal slipped, yet they were also sympathetic for the good reason that while every accountant exercises all his vigilance to discover fraud, he knows that fraud on the grand will always exist and not every crook can be caught. Coster was another Kreuger, they argued. It might have happened to any of them.’
4.3.1 The UK scene

During the 1930s, rationalisation and reconstruction plans continued in UK (Green & Moss, 1982, p147-203). Their quaintly titled Chapter 9 ‘Unscrambling Eggs’ contained this observation (1982, p165),

Not since 1878, when the City of Glasgow Bank failed, had the financial community been forced to admit that large numbers of private investors had lost the greater proportion of their investments in a number of respected companies that had enjoyed the confidence of leading financiers and financial journalists.

Sentiments like these are certainly consistent with the arguments Chambers would use in developing his CoCoA as a publicity-oriented accounting system – a device to control corporations and protect investors.

The 1931 RMSP case met earlier provided a major shock for the UK profession (Birkett and Walker, 1971). The trial focused the criticisms made of accounting reports for the previous 30 years, particularly by the judiciary. Until then (and even subsequently) the professional bodies had looked to the legislative system to determine what should be reported about a company’s financial affairs. Arguably, the caveat emptor/laissez faire view still dominated.

In 1935, the Society of Incorporated Accountants and Auditors created the Incorporated Accountants’ Research Committee to direct research of advantage to the profession, as well as considering the practicality of undertaking such research. Its first publication was a comprehensive series of model accounts for various types of business (Zeff, 1972, p3-4; Hein, 1978, p80-81).

Rather than publishing a series of pronouncements like those of the AIA, the Committee sponsored a number of publications on accounting theory and procedural applications, including those in 1930s by Sewell Bray (Zeff, 1972, p5; Hein, 1978, p199).

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336 The plans would continue until the outbreak of WWII – in Europe in 1939 and in the Pacific in 1941 (Green & Moss, 1982, p194).

337 In 1939, the London stock exchange introduced a listing requirement for companies to publish consolidated balance sheets and profit and loss statements (Zeff, 1972, p16 & 57; Nobes & Parker, 1979, p199).

338 Green & Moss (1982, p215) conclude, ‘... the collapse and eventual reconstruction of the Royal Mail Group, which was almost certainly the largest corporate exposure in British history, shaped subsequent policy towards and expectations of business, and permanently and substantially modified the established commercial framework.’

339 Evans (1974, p34) notes ‘the subsequent shock to the public prompted leaders of the main UK professional bodies to become greatly concerned with the financial information that should ... be included in an annual report.’

340 Benston (1976, p485), ‘The U.K. professional accountancy bodies have not been as active as their U.S. confreres in promulgating disclosure rules.’

341 This series, entitled “The Design of Accounts,” was published serially in The Incorporated Accountants Journal under the title ‘The Design of Accounts’ and published in book form as Bray and Sheasby (1944).
p81) and in 1938 by Edwards (Nobes & Parker, 1979, p199). The scene was set for rethinking of, and debate on, accounting.

4.3.2 Accounting interactions

An agency theory thrust saw duties of directors and related management take on a paid agent function in a shareholders only relationship. Others take a broader view of the relationships in the context of stakeholder theory where directors are seen as trustees for the whole society. Certainly, interest groups like financial analysts, superannuation fund trustees, banks, employees and unions, financial journalists and regulatory agencies sought a report of stewardship in a broader sense (Previts & Merino, 1998, p240-241).

Debate follows if a move is made from a narrow stewardship to a broader decision-making function. Jardine (1931, p119) argued that if one part of the corporate reports - the balance sheet - had, as in trust accounting, simply a narrow stewardship function, inconsistencies were found with the adoption of a decision-making (and broader stewardship) function sought by various stakeholders. When financial statements were filed with say NYSE, they became available to the public.

Much was expected of the profession's republishing of the 1917 statement in 1929 under the title "Verification of Financial Statements." However, other events created tensions for accountants, including Berle’s (1933) conference paper.

Carey (1969, p40) writes, 'The [Berle] speech was something of a shock to the Institute audience. With the growing importance of accounting in the economy, Berle argued that accounting was rapidly ceasing to be a private matter. He questioned several accounting practices that might distort comparisons. He stressed

342 Jardine (1931, p119), '... the subsequent rapid development of accounting as an essential aid to management, and more particularly the balance-sheet as a basis for the extension of credit, there has been evident a tendency to overlook and obscure the character of the balance-sheet as in part purely a statement of trust moneys received and expended. There have been adopted, in fact, certain accounting processes which render the balance-sheet in some cases quite unintelligible as an accounting for invested capital funds.'

343 The roles of the auditor and related standards were also under scrutiny. However, it is possible to argue that the results were rather cosmetic. Carey (1969, p41) writes of a recommended change in the form of audit certificate. Auditors would specifically report whether the accounts were prepared in accordance with the methods of accounting regularly employed by the company.

344 Carey (1969, p42) writes, 'The accountants pointed out that this bulletin was "framed to fit the case of borrowers engaged in business on a relatively small or medium-sized scale," and that in larger corporations, with effective systems of accounting and internal control, less extensive detailed checking was required by the independent auditor.' See also Previts & Merino (1998, p290).

345 Chatov (1975, p72), 'The paper was called "Public Interest in Principles of Accounting." It was typeset by the Journal of Accountancy, and run off, but never published. The copy in their files is marked "Confidential," but there is no indication why the paper was so designated at the time.'

346 The meeting was approximately four months after enactment of the Securities Act of 1933, but Berle, despite accepting an invitation to speak at the annual meeting, was unable to appear personally. His paper was read by Walter A. Staub, a practitioner from a large accounting practice in New York.
the need for comparison of the results of one company with others in the same industry. However, he argued that consistent principles of accounting and their development were to be subjected to test in two areas. First was that of public opinion and public desirability. Second was their effectiveness in specified private transactions.

Regarding who should develop the principles, Berle was content with initial attempts being made by accountants, acting through their professional organizations. However, he questioned whether that would transpire as he doubted whether individual accountants could maintain completely impartial minds as they were closely related to management. His prediction that a bureau would be set up (presumably in the Department of Commerce) to standardize accounting practices in various industries shocked the profession.

In his discussion, Staub contended that some questionable accounting practices had already been eliminated by either the accounting profession itself or the stock exchanges. Others were to be eliminated by the cooperation between AIA and NYSE. He also objected to the proposal of accounting practices being developed and standardized by a government agency. He suggested (without providing systematic evidence) government control of accounting (under the ICC, in the utility field and under the bank regulatory agencies) had been unsatisfactory. He also challenged perceived doubts by Berle of the independence and impartiality of public accountants. While Carey (1969, p40) writes, 'Other members ... urged the Institute to take affirmative action', Chatov (1975, p68) suggests they were few in number.347

Carey (1969, p46) highlights the role of accounting:

Numerous questions arose during the early years of the 1933 and 1934 Acts requiring interpretation of their provisions and related regulations. Since many of these involved accounting questions, the Commission decided to create the Office of Chief Accountant.

Blough was appointed.348 Having been both a practitioner and an academic he was aware of potential tensions among groups (Blough, 1937; 1937a).

347 Chatov (1975, p68), 'It was not easy to create a paper abrasive enough to be certain of offending just about everyone, but Berle, always the innocent progressive, managed to bring it off. Almost any one of the several allegations and suggestions made were sure to make wild men of the usually controlled, placid, practicing accountants: comparability of firm accounts within an industry! a government bureau to develop accounting systems! standardized accounting! no individualism in business! accountants wholly directed by their clients!'

348 Carey (1969, p46) continues, 'Carman G. Blough was appointed to this new post. He had served in the SEC as security analyst and as assistant director of the registration division. He held CPA certificates of Wisconsin and North Dakota, and had served at one time as a member of the Wisconsin State Board of Accountancy. He had taught accounting at several universities, and was head of the accounting department of the University of North Dakota for four years. For more than five years he was a member of the staff of the Wisconsin Tax Commission, and for two more years was secretary of the Wisconsin State Board of Public Affairs, in charge of budgeting and auditing for all state departments. He was destined to have great influence on the technical standards of the profession in the years ahead.'
The threat of SEC intervention continued. Carey (1969, p47) writes that praise of the profession’s substantive contributions to improvement of corporate reporting, alternated with frank criticism of the profession’s failures of omission or commission.49

The reporting function under conventional accounting was often not stated in an explicit manner. The practitioner wing of the accounting profession, under May’s guidance, provided the function with an implicit input-oriented direction within a narrow stewardship. This certainly caused tensions.350 Whether all stakeholders were aware of, agreed with or followed the conventions was debatable.

An Editorial (1933, p161-162)351 introduced in evidence the May-AIA committee report summed up thus:

*It (the committee) believes that there are two major tasks to be accomplished – one is to educate the public in regard to the significance of accounts, their value and their unavoidable limitations, and the other is to make the accounts published by corporations more informative and authoritative.*

This certainly sent equivocal messages from accounting practitioners to other stakeholders. Under conventional accounting, the limitations of the related reports (of questionable value) suggest a narrow stewardship. On the other hand, the reports were to be ‘more informative and authoritative’. The ‘authoritative’ criterion arguably was met by the ‘professional status’ of the accountant. However, the criterion of informative seems inconsistent with the output provided. This was especially so as the Editorial (1933, p162-163) concluded with the usual May items,

- what a balance sheet is not,
- a balance sheet is based on conventions,
- the primacy of the income statement, and
- broad principles of accounting which are generally accepted.352

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49 Carey (1969, p47), 'The criticism was sometimes mingled with thinly veiled threats that the Commission might exercise its latent powers to prescribe accounting principles and methods if the profession did not move forward more rapidly. The influence of the SEC on accounting and auditing standards and practice was tremendous.'

350 May (1936, p114) would stress 'a body of conventions, based partly on theoretical and partly on practical considerations, which form the basis for the determination of income and the preparation of balance sheets today.'

351 This commented on hearings conducted by the Committee on Banking and Currency of the United States Senate into the causes of the Kreuger & Toll corporate collapse (arguably the 1930s equivalent of Enron).

352 Editorial (1933, p162-163), 'The report closes with a series of four specific recommendations ... 

1. To bring about a better recognition by the investing public of the fact that the balance-sheet of a large modern corporation does not and should not be expected to represent an attempt to show present values of the assets and liabilities of the corporation.

2. To emphasize that balance-sheets are necessarily to a large extent historical and conventional in character and to encourage the adoption of revised forms of balance-sheets which will disclose more clearly than at present on what basis assets of various kinds are stated ... 

3. To emphasize the cardinal importance of the income account, such importance being explained by the fact that the value of a business is dependent on its earning capacity ...
Any statement on the method of accounting in the business was to cover any principles used in the classification of charges and credits among the balance-sheet, income account and the surplus account.

The May Committee's approach and results met the various threats faced by the profession (Carey, 1969, p47-48). Practitioners spearheaded the attack on the SEC's powers to develop AAP to guide reporting practices by corporations. The dilemma was obvious to May (1943, p58-59), who would attack the New Deal reforms. The Securities Act to him was not the result of judicious inquiry and dispassionate legislative consideration. Instead, it was passed under the pressure of public indignation and investigations lacking in judicial quality. He questioned the claims of the promoters of the law, arguing representations of many were no better than the ones complained of. His views supported control via personal qualities.

Others would of course disagree. de Bedts (1964, p204-205) commented on the scene favourably. Controls were required and the New Deal/SEC would provide them over corporate and financial dealings.

Interestingly, even May (1943, p59) saw some benefits for the profession, but at substantial costs. The law gave legal recognition to the function of the independent public accountant but also gave a non-expert body - the SEC - powers over the profession. From a pecuniary point of view, the effect on accountants was favourable but professional status was impaired. To May (1943, p50), controls in accounting...

4. To make universal the acceptance by listed corporations of certain broad principles of accounting which have won fairly general acceptance…"

353 The resulting five broad principles dealt with
- unrealized profit not be included in income,
- capital surplus not being part of income,
- the treatment afforded pre-acquisition profits of a subsidiary,
- the exclusion of dividends on treasury stock from income and
- separate disclosure of items like loans to officers of the corporation.

Merino & Coe (1978, p67) suggest of the philosophy underpinning their establishment, 'This emphasis on the limitations of financial reports could be viewed as an adverse reaction to increased responsibility being placed on the profession, but it is probably more accurate to interpret this as an effort by accountants to warn investors that financial reports could never attain photographic accuracy.'

354 They would also influence the form and content of the audit report and related auditing standards.

355 de Bedts (1964, p204-205), 'As a political achievement the SEC owed no debt to expediency. Its genealogy was abundantly evident. It incorporated the Progressives' concern with moral values into the practical reform framework of the New Deal to produce an agency embodying most successfully the lasting values of both eras. In principle and in method, it had carried to a successful conclusion the efforts of those who, concerned with the dominant role of financial and corporate power, had seen their attempts of the previous three decades dismissed by an economy and a Congress dedicated to just such hegemony. A great market crash and its consequent revelations enlisted in the support of a new administration a broad public sentiment against the existence of separate and privileged standards of morality for the corporate and financial world.'

356 May (1943, p71) lamented, 'If 1918 saw the authority of the accounting body in America at a peak, the years 1933 and 1934 saw it at a low point. It may well be that its rise was too rapid to be altogether healthy, and that it can now re-establish itself on a sounder basis. It cannot, however, do so unless it can regain the professional ground of which the Securities Act of 1933 deprived it.'
were to be resolved at the ‘professional’ level rather than as part of CG regulatory reforms.358

May was in a position to reinforce the ideas of the NYSE-AIA self-regulatory approach rather than the potential SEC-uniformity approach. He argued that enhanced ‘professional accountant’ status (1943, p65) would draw into that body more men of high quality than under regulation it was likely to attract. Once again the theme met was that the values of the accountant were able to overcome any deficiencies in the actual accounting process or its output. That being the case, there was little, if any, need for the regulation by the State.359

Others were not so sure, preferring some regulation. de Bedts (1964, p28) argued that the time of reform via legislation had come. Various stakeholders had read and appeared to accept the lessons from investigations which found corruption, mismanagement and lack of action from groups which might be expected to provide protection.360

While in favour of the extension of protection to be afforded investors, to May investors would be protected by professional developments rather than legal regulation. He would continue with familiar themes:

- the primacy of the income account,
- financial reports were not statements of fact and had limitations,

357 May argued (1943, p64-65): ‘Looking to the future, I am convinced that the grant of power to the Federal Trade Commission, and later to the Securities and Exchange Commission, to control the accounting of general business corporations whose securities are listed, was not in the public interest. It seems to me to have been the more unnecessary since an alternative procedure, more in harmony with the American system of checks and balances and more likely to prove efficacious, was ready to hand.’

358 May (1943, p50), ‘There will always remain ... questions which can be rightly decided only by good judgment and regard for business morality.’

359 In the context of professions May (1943, p70-71) wrote, ‘The development of such a profession has a social value. Its existence, together with the high prestige and authority of the upper branches of the English Civil Service, has made the approach to business questions much less legalistic in England than in America.

‘Here, the legal profession early assumed a dominant position in the business life of the community, and the position thus created has tended to perpetuate itself. The fact that admission to the bar opens the road in so many directions naturally draws into the profession a large proportion of the best brains of the country and makes more difficult the development of an independent profession which might usefully take over a part of its functions. Only in comparatively recent years have any considerable number of college graduates of more than average qualifications entered the accounting profession .... Intimate contact with outstanding members of both professions here and in England convinces me that the habit of mind that accounting experience develops, with its emphasis on essentials and willingness to disregard form, is a valuable corrective to the legal mode of thought.’

360 de Bedts (1964, p28), ‘The nation had time to reflect on the crash of fiscal empires and the resulting rubble of corrupt financial foundations. It could more readily glimpse a Congress that was determined to sidetrack serious efforts at reform in the issuance of securities, and a national leader whose occasional threats of regulation of the exchanges were obviously belied by his expressed political philosophy and the more frequent entreaties he addressed to the perpetrators. The New York Stock Exchange mirrored only too plainly the light regard in which it held political efforts at regulation. Its rule changes were chiefly innocuous ones and, in any event, were clearly devised from a viewpoint of protection for its own members rather than for the investing public or the national economic welfare.’
• the competence and integrity of those who prepare accounts in general and of accountants in particular are key factors, and
• the public was to be educated to accept these ideas.

At best, such proposals may be seen as defensive of the position in which accountants and their profession found themselves. Investors were at fault, as they believed that financial reports dealt with factual and current data whereas the reports, and the related audit reports, included opinions and non-current data based on conventions. It is possible to be extremely critical of such arguments as being simply psychological attempts to avoid responsibility for the promotion of at best confusing and at worst outright misleading financial statements.

The May Committee was reformulated in 1938 (Zeff, 1972, p134; Chatov, 1975, p133-137) as Committee on Accounting Procedure (CAP) in response to claims that officers of the SEC were generally dissatisfied with the work on AAP.

A research department was established to study particular topics with a view to formulating rules or principles on specific issues. This approach contrasted with the work carried out by academics who, through the publications of their AAA, had written of the need for a theory to support AAP. The results of various research and discussion were published in 1936, leading to tensions between practitioner and academic wings of the profession. As well, debate on terminology was to continue, both regarding meanings and level of understanding.

A case of practitioner dominance and control over accounting reports and underlying principles had emerged. However, that is not to suggest that some academics like

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361 Zeff (1972, p131-132) writes of initial difficulties faced between practitioner and academic groups, especially when works by AAA met with some hostilities. Zeff (1966, p43-46) describes how events saw a more amicable relationship in place by 1939.

362 Collins (1938, p294) lamented, 'For many years the American Institute of Accountants has had a committee on terminology which has been conscientiously endeavoring to build up an accounting dictionary, but, sad to relate, the dictionary does not yet contain its first word. Here again, the inherent attitude of mind of the accountant has been a stumbling block. The very nature of his profession and his training impel him to be cautious, and if a given definition does not cover every shade of meaning which his experience leads him to believe it should have, he is inclined to brand it as wholly erroneous and lacking in authority... Can we not begin the building of our accounting dictionary by embodying therein a set of definitions representing the more commonly accepted uses of the terms and to this nucleus add refinements of definitions as they will naturally develop through experience?'

363 Editorial, (1935, p81) commented, 'Corporations are given a wide latitude in the manner of presenting the required data. The emphasis has been on substance rather than on form, and the criterion set by the commission is that it must secure the facts about which "an average prudent investor ought reasonably to be informed" ...

364 A summary is provided by Chatov (1975, p10-11) who writes of these times, 'The ... accounting profession, ... the practitioners especially ... spearheaded the attack on the SEC’s powers in the years immediately following passage of the Securities Exchange Act of 1934. They threatened, cajoled, and balked the SEC over the issue of authority for developing generally accepted accounting principles. Once they succeeded in obtaining it, they administered that function exclusively for a generation until forced to share it with other private groups in the early 1970s. They remain a potent force, probably holding more prestige and power than any other group in [setting] corporate financial standards.' Chatov (p147-152) includes a section titled 'The Freezing Out of Academe.'
Ripley then and Chambers later) did not directly nor indirectly influence the reporting process. The Ripley argument met earlier would be labelled ‘academic’; that of May as ‘practitioner’. Under the latter, a series of ‘conventions’ to be developed by practitioners would be followed. Tension is also illustrated in an exchange between Peloubet and Kelley as to what was a balance sheet and what was its role.365

Kelley (1935, p52) followed the view that the balance sheet was an instantaneous photograph of the business, although apparently thinking this analogy could be taken too far. While not too much may be inferred from Kelley’s reasoning, the terminology used may be seen as a little ahead of its time as he strongly argued that ‘value’ and ‘price’ were distinct (though related) concepts.366

While Peloubet (1935a) questioned the logic of Kelley's reasoning, it is interesting to note that Peloubet too uses terminology (for example, past or present cost, market price or value) beyond that found in AAP of that time. This debate is returned to in Chapter 8.

Selected works of the AAA provide a proxy for the academic wing. In this and later chapters, various monographs and statements are deconstructed to identify issues of accounting in general and of liabilities in particular. Arguably, some involved in today’s standard-setting may be unaware of how the current suites of ideas embodied in say modern CFs (see Chapter 7) has come to pass.

AAA, through various publications, wrote of the need for a theory to support AAP.367 The approach was seen to be in contrast with the work carried out by the Institute.368 At the time of publication of AAA (1936), the career of one ‘Philip Musica/William Johnson/Frank D Costa/F Donald Coster’ (met in 4.3) had reached its infamous peak. He was a leading businessperson of the time, being head of the giant pharmaceutical firm McKesson & Robbins Inc, the antecedent of Foremost McKesson, a major corporation in 21st Century. He was even considered as a potential Republican candidate for President of the USA.369 The major fraudulent case was uncovered.370

365 Their debate hinged around the topic “Value as an Accounting Concept” as in Peloubet (1935).

366 Interestingly, Chambers was to use a similar distinction, hoping to avoid confusion, within in a decision-making context. Sterling argued in a similar manner.

367 The results of various research and discussion were first published in 1936 under the title ‘Tentative Statement of Accounting Principles’.

368 Of the AAA 1936 Statement, Hendriksen (1965, p68) commented, ‘In contrast to the specific approach of the American Institute, this broad approach was adopted by the American Accounting Association primarily because of the limited resources of the Association and because of the theoretical orientation of its members.’

369 Keats (1964, p3-4) reports, ‘The bank president cleared his throat and said: “Dr Coster, we think you should be a candidate for President of the United States.” ... There was a ground swell in the making. It could very well carry him far – at least to the 1940 Convention, if not to the White House.’

370 Keats (1964, p116), a journalist who wrote of Coster and the aftermath of his suicide, commented of the fantastic paper portion of Coster’s empire, ‘McKesson and Robbins Ltd., of Canada, was now meticulously following all the proper practices and procedures of accountancy.’
Consequences included further questioning of the data provided under conventional accounting (MacNeal, 1939/1962), furthering tensions of government intervention.\(^\text{371}\)

MacNeal sought the preparation of informative reports (including financial statements) which enabled the market place to generate prices based on factual information rather than on mere speculation. Reports prepared by accountants under conventional accounting have of course been questioned by those like Ripley (1926, p50) who found 'accountants are enabled to play ball with figures to an astounding degree'.

It was within such a context that attempts to formulate a 'theory' of accounting were made. In the original Statement in 1936, the Committee (AAA, 1957, p60) 'attempted to set forth some of the bases upon which accounting statements rest; it has not tried to establish the postulates of all accounting theory and procedure.'

Of interest was the claim (p60), '...it should be possible for a person moderately experienced in business and finance to examine such statements with the expectation of deriving from them the basic facts on which at least tentative business judgments may be premised.' This potentially agreed with Ripley's argument rather than that of May. However, to overcome criticisms of accounting, more precise definitions of functions and terms would be needed.

As regards the function of accounting, some commentators raised the point that 'the committee did not attempt to cover every phase of accounting theory' (Rorem, 1937, p133). Consistent with the AIA/May approach, accounting was an allocation process.\(^\text{372}\) This is considered the 'fundamental axiom', being 'derived' from a basic assumption as to a corporation's periodic financial statements.

This basic assumption has two parts – the statements being in accord with a single coordinated body of accounting theory and the purpose of the statements. The reference to a body of accounting theory had the potential to differ from the procedure driven approach of May.

As to 'purpose', the key step appears to be from the phrase 'expression in financial terms' to the 'fundamental axiom' of accounting being an allocation process. The reasoning underlying this step is not explained. Instead, the step reflects an attitude to accounting in which, despite arguments like Ripley's, a profit determination process held sway.\(^\text{373}\)

\(^\text{371}\) Ripley (1926, p226-227) had commented on cases of government interference with business. Sometimes it was to penalise for infraction of law. Others he saw as preventive in nature. He contemplated constructive interference to allow informed action by participants to function towards setting true market prices, the 'Truth-in-Securities' thrust of the New Deal/SEC initiative. If accepted, this would deflect the often destructive criticism (offered especially by business and practitioners) that missed the point on government legislation.

\(^\text{372}\) The definition reads (AAA, 1957, p61), 'Accounting is thus not essentially a process of valuation, but the allocation of historical costs and revenues to the current and succeeding fiscal periods.'

\(^\text{373}\) Graham (1940, p146) argues, 'The balance sheet thus becomes not a statement of present values, but a statement of historical facts relating to the investment of funds in the business, the disposition of such
Why the Committee chose to move in this direction is a source for speculation, especially in light of the claimed motive of providing facts for investors with moderate experience to make informed judgements. Some were to attack this narrow, technical description of the function of accounting (Scott, 1937, p303374; Kaplan and Reaugh, 1939, p228375).

Greer (1937, p80) suggested problems arose from a lack of definition concerning the charging, in the income calculation, of items reflecting a loss in value. However, little discussion is devoted to the definition of terms used in accounting. Definitions included are of a 'consist-of' type (AAA, p63). These definitions, with an emphasis on classification and subdivision, are in the nature of formal definitions. This emphasis rather than one on 'primary definition' was the grounds for Rorem's (1937, p135) criticism.

The Statement did produce debate (and related tensions). Blough (1937b) was generally in favour of the 1936 Tentative Statement. Related principles-type papers came from Sanders (1937) and Byrne (1937) on which Greer (1937) commented. Andrews (1938) was most critical of a contribution by May (1937) and supported parts of Byrne's argument.

An attempt to develop AAP by the Haskins & Sells Foundation, Inc., sought to establish a body of accounting principles to unify accounting thought and to standardize accounting practices. The outcome sought was for the authors to draw funds, and the reflection of changes in condition brought about by the conduct of the business… Profit determination in turn is the sine quo non of accounting since valuation of securities by investors rests upon reported and anticipated profits.'

Scott (1937, p303) argued, 'The best means of guarding against the misuse of accounts is an intelligent constructive guidance of their developing functions. The Tentative Statement of Principles does not assume such a responsibility. It presents a narrow conception of accounts.'

Kaplan and Reaugh (1939, p228) argued, 'The accountant finds it safest, therefore, to resort to historical cost figures, and accountancy becomes “not essentially a process of valuation but the allocation of historical costs and revenues to the current and succeeding fiscal periods”. Few investors appreciate that the asset figures must be interpreted so narrowly.'

Greer (1937, p80), 'The decision here is not a matter of judgment; it is a matter of definition. Accounting characteristically has been long on judgment and short on definition.' Greer would elsewhere write of 'accepted principles' (1938) and 'rules and standards' (1938a).

See for instances paragraphs 14 and 18 on the discussion of 'capital' and 'earned surplus' respectively.

Rorem (1937, p135), 'This section [on the measurement of income] is not well named ... [it deals] with the classification of income rather than its measurement ... the resultant emphasis upon subdivision rather than primary definition.' Further analyses of terminological and of measurement issues continue in Chapter 8.

Appointed was 'a committee of university men whose independence and impartiality will be unquestioned, in the belief that this will be the most effectual means of supplementing existing agencies working to the same ends, and the committee will be able to enlist the assistance and support of those who have the practical experience necessary to sound conclusions' (Sanders, Hatfield & Moore, 1938, pxiii-xiv).
up a report containing 'a reasonable number of accounting principles, based on practical business concepts of capital and income, which will merit the approval of those competent to judge of their soundness, and thus attain to general acceptance' (Sanders, Hatfield & Moore, 1938, pxiv). The result was published in the mid-1930s, an extremely embarrassing period for some in the accounting profession.

This attempt is of interest here as it included the legal influence as well as the financial and economic ones. As will be shown in Chapter 8, legal factors were to influence debate when assessments were made of the application of CoCoA methods to liabilities.

Littleton (1938) attempted to reconcile into one set of principles those found in AAA (1936), SH&M (1938) and Byrne (1937). Later, Littleton (1939) strongly supported the stated purpose of the allocation of historic costs. This was best seen in his discussion of the cost or market rule for determining the monetary amount for inventory. He argued that any adjustment was not to be included in the Income Statement but rather be shown as a 'surplus' adjustment or a 'non-operating loss'. Lorig (1937, p401) disagreed, preferring an emphasis on a provision of useful information and was very critical (p402) of the proposed principles. Stempf (1938, p57-58) too was most critical of the stated function of accounting.

Nelson (1939, p350) was supportive and suggested interested parties 'should be grateful' for the 1936 AAA Statement. Others like Rankin (1940) would refer to both AAA (1936) and SH&M (1938) in various arguments. Sweeney (1937) provided a general overview and referred to related articles by Banks (1937), Carman (1936) and Montgomery (1937).

However, a profit-determination allocation process continued to be dominant. As already mentioned, this would result in the balance sheet becoming a statement of current values only by chance and more likely a statement of historical data with some strange balances appearing as assets or liabilities. Few people other than fellow accountants seemed to appreciate that the figures had to be interpreted in such a narrow manner.

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380 Sanders, Hatfield & Moore (1938, p3), 'In addition to the financial and economic factors, one other general element enters into the preparation of financial statements, namely, the legal element. It is the function of the liabilities side to show the amounts of the different classes of equities or interests in the assets listed on the other side of the balance-sheet. To this extent, therefore, the principles of accounting are dictated by legal considerations; in fact, it has been said that the ultimate function of accounting is to make proper allocation between the respective equities.'

381 Lorig (1937, p401), 'They make of conservatism a god so domineering that the objective of accounting - providing useful financial information for intelligent guidance - is somewhat forgotten.'

382 Nelson (1939, p350) concluded, 'Fortunately much of the recorded disharmony is more apparent than real.'
A Subcommittee (1941, p60) examining SH&M was to question this basically legal approach. The subcommittee preferred Paton & Littleton’s (1940) basic premise of ‘a periodic matching of costs and revenues.’ This monograph was seen as an answer to the challenges posed by the New Deal proposals for ‘truth in securities’ (Previts & Merino, 1998, p231).

As well, Accounting Research Bulletins (ARB) were to be issued, it being noted the demand for uniform accounting information was now coming from traders in the securities market rather than from continuing owners, the significance of the income statement again being stressed. ARB1 (1939) and earlier ones received a lukewarm response (Zeff, 1972, p134). However, other ARBs followed until 1941 and the entry of the USA into WWII. They were seen as being constructive responses to criticism from bodies such as SEC and AAA and arguably had some influence on corporate reporting as SEC provided authority to the publications by requiring registrants to follow the practices recommended.

Pressure to eliminate alternative ways of accounting for similar events continued to come from various sources including SEC, AAA, elements within the Institute itself, financial analysts and the financial press. Other groups, including some corporate management and trade organisations, resisted, preferring the status quo.

Scott (1937, p296) was one who stressed ‘that all accounting principles and practices must preserve a vital functional relationship to a world of changing economic facts.’ This was a general criticism to be made of the 1936 AAA Statement which he thought inadequately recognized the changes. Reasoning underlying applications would continue to be debated (Kohler, 1939).

4.3.3 Reporting of liabilities

During this period, questions of form and application continued to be addressed. As pointed out in the previous sub-section, AAA (1936) provided some underlying reasoning, but basically followed the May approach.

The term ‘liability’ is used once (para11, p62) and then simply in connection with the treatment of any gain or loss arising from a liability being discharged for less or more than its recorded amount. Mention to ‘creditors’ is made (Introduction, p61), to ‘obligation’ and ‘indebtedness’ (para6 – again in connection to the treatment of any differences between gross amount and maturity amount of the obligation), to ‘borrowed money’ (para10, p62) and to any ‘surplus set aside for contingencies’ (para13, p63).

383 The Subcommittee (1941, p60) argued, ‘These comments prompt the thought that it may be prudent to avoid basing the entire discussion of accounting principles on the premise of the distinction between capital and income.’

384 He continued (p303): ‘The best means of guarding against the misuse of accounts is an intelligent constructive guidance of their developing functions. The Tentative Statement of Principles does not assume such a responsibility. It presents a narrow conception of accounts.

‘Perhaps the burden of the complaint in this article can be expressed best by saying that the work of the committee has been directed towards a constructive development of practice without a corresponding and necessary constructive development of theory.’
The Statement contains little specifically on liabilities. Husband (1937, p391) agreed.\(^385\) The emphasis remained on assets. Valuation of physical assets is discussed, assets being that part of original cost which ‘should be carried forward as reasonably applicable to future operations’ (para1, p61). Interestingly, Husband (p388) suggested that the term ‘value’ be eliminated from the accountant’s vocabulary. Arguably a major contribution to accounting was the discussion the Statement aroused, thus fulfilling the claim (AAA, p60), ‘It is hoped that their publication may arouse discussion and that a more comprehensive formulation will develop.’

Blough (1937b, p31, 33, 34) briefly discussed issues of liabilities. Lorig (1937, p402) used the term 'obligation'. One major point was the lack of definition of terms, on which Littleton (1938, p234) recommended, ‘Vagueness should be eliminated and words carefully chosen, with definitions being given in many cases.’ Dohr (1939, p38-39) argued in a similar manner.\(^386\)

The particular problem of the treatment afforded bond discount or premium and the related valuation of the liability incurred for those bonds was addressed in AAA 1936 in a way seen as a departure from practice.\(^387\)

As shown in previous sub-sections, problems here had been debated for some years. Accounting Questions (1933) dealt with the practice of including in the cost of a project the interest until the extensions were in use. Paton (1934, p115) disagreed with the idea of a deferred debit being an asset, but noted the practice of combining bond discount and other costs.\(^388\)

In the context of AAA (1936), Paton (1937, p286) argued for a discussion of ‘character’ and ‘amount’ of a liability.\(^389\) The introduction of an ‘effective’ amount of

\(^{385}\) Husband (1937, p391, footnote 9), ‘It should be noted that the postulates say little specifically concerning liabilities.’

\(^{386}\) Dohr (1939, p38-39), ‘There is still a good deal of confusion, however, due largely to the lack of uniformity and definition in balance sheet terminology and to the use of narrow or “specialized” methods of approach in our efforts to solve the problem. This is particularly true of the ‘net asset’ section of the corporate balance sheet. Here the reader encounters a wide variety of inadequately defined and misdescriptive terms such as ... equities, ... liabilities, ... etc. Further progress is therefore dependent upon a greater accuracy in the use of terms and the adoption of a broad or general point of view.’

\(^{387}\) Rorem (1937, p135) noted, ‘Only one statement is made with regard to the valuation of liabilities, namely that “bond discount” represents a reduction of indebtedness ... The logic of the committee’s position must be admitted, and here a definite departure from current practice is recommended.’

\(^{388}\) Paton (1934, p115), ‘With respect to discounts on bonds and similar securities the universal practice is to treat the amount of the discount, usually amalgamated with the underwriting and other issuing costs as a deferred charge to operations.’

\(^{389}\) Paton (1937, p286), ‘... it is necessary, as a preliminary step, to consider the character and accounting significance of liabilities in general. The impression that a liability is a fixed, unvarying amount throughout the life of the contract, which seems to be lodged in the minds of many accountants, is entirely unwarranted by legal and financial conditions obtaining and is regularly denied by the accountant’s own procedures. The plain fact is that the effective amount of a liability changes systematically throughout the term of the indebtedness.’
a liability had implications for the measurement debate (Chapter 8). Sweeney (1937, p404) approached the debate in a different fashion.\textsuperscript{390} From a stated definition, he analyses various cases (using rhetorical questions) to conclude that two types of liabilities (actual and conventional) were found, suggesting a need for two distinct definitions.

Debate continued. Banks (1937, p60) could see no reason for denying that the discount might be included in the cost of the building. Accounting Questions (1936, p473) suggested it was good accounting practice to carry forward any unamortized debt discount and expense as well as premiums paid on bonds refunded. A variation on this matter arose in the discussion in Notes of the Month (1939, p106) of SEC Release No. 10 in 1938. A distinction was seen in the treatment of the unamortized amount of bond discount and expense at date of retirement where

1. the retirement was financed by the sale of capital stock, and
2. the retirement was financed by other evidences of indebtedness.

Cranstoun (1939a, p179) questioned the distinction itself, formulating questions dealing with ‘principle’ and ‘practice’. He (p179) answers the latter first, arguing considerable research would be necessary to make a confident assertion as to the general practice.\textsuperscript{391} Cranstoun’s (p179) answer to the question of ‘principle’ restated arguments that two ways of paying ‘interest’ exist. It is not questioned whether or not the total of ‘coupon payments’ and ‘bond discount’ is to be termed ‘interest’. The argument why the effective rate of interest should determine the expense amount in the period income summary and its effect on the valuation of the liability is not advanced. His assertions, independently, do not seem invalid especially to one familiar with accounting jargon. However, taken as a whole they do not seem to comprise a convincing argument.

While appearing quite plausible, conflicting treatments remained possible. Perhaps indicative of the malaise plaguing accounting was the Editorial (1939, p136-137) on Cranstoun’s comments.\textsuperscript{392} However, if conflicting ‘reasoned opinions’ were possible, how could the ‘position’ to be taken decided and the validity of any criticisms tested?

\textsuperscript{390} Sweeney (1937, p404), ‘The definition of the term liability as given by the National Committee on Municipal Accounting is as follows: “debts or other legal obligations arising out of transactions of the past, which must be liquidated or renewed or refunded upon some future date”. It is to be noted that the debts are legal ones. Is it too far fetched to assume from this definition that the debts to be reported are legally enforceable claims – not necessarily in legal process, of course – and the amount which presumably a debtor can currently assert if called upon to do so? … If it is urged that a debt discount is a negative liability can it not also be urged that a debt premium is a positive liability? Certainly it is difficult to regard a debt premium as a liability under the above definition of a liability. Is it not just as difficult to regard a debt discount as a reduction of a liability under the above definition? Do we need definitions for two types of liabilities, one perhaps for effective liabilities and the other for ineffective liabilities?’

\textsuperscript{391} This valid criticism of the SEC conclusion is an equally valid criticism of Cranstoun’s stand, as he too would require ‘considerable research’ to support his claim that practice has not conformed to SEC’s opinion.

\textsuperscript{392} Editorial (1939, p136-137), ‘We have suggested that The Journal of Accountancy be used as a medium for discussion of S.E.C. accounting releases, and this month we publish criticism by W.D. Cranstoun, editor of The Commentator of release No. 10, the text of which was printed in the February
It would not seem unreasonable to expect an answer to this question in ARB2 (1939). However, alternative treatments were ‘regarded as acceptable accounting practice’ to which Freeman (1935; 1939, p397) took exception.

May (1940), a vice chairman of the committee which prepared ARB2, attacked Freeman’s proposal, but did not come to grips with Freeman’s line of reasoning and supporting argument, making assumptions which effectively limited debate. Whether May intended one to assume that ‘a realistic financial basis’ was compatible with the criterion ‘proper to carry forward’ is not certain. May was concerned with ‘accounting questions’ only, as was Cranstoun. There is no discussion of whether or not the refunding is, in Freeman’s terms, ‘advantageous’.

The situation remained far from settled. Cranstoun (1939, p46) wrote of the difficulties faced in trying to interpret the balance sheet of the Toledo Edison Company (a public utility) at May 31, 1938. Different treatments were afforded various parts of the ‘liability’, suggesting tensions remained at both the underlying reasoning and application levels.

In discussing contingencies, Fisher (1933, p16-17) raised several issues, including the relationship between law and commerce. In law, contingent items were identified with dependence upon some event which may occur in the future. In commerce, Fisher suggests three distinguishing characteristics exist:

- probability of maturity,
- time of possible maturity, and
- type of matured claim which may have to be satisfied.

Fisher concluded that alternative treatments are necessary and available for contingent liabilities.

Debate persisted. Paton (1934, p119) wrote of varied ‘objectionable practices’. He (p121) also suggested that an intermediate group between ‘typical liabilities’ and ‘net

393 May’s opening paragraph (1940, p49) included, ‘I shall assume that it is proper to carry forward the discount and redemption premium beyond the date of refunding, and shall limit my discussion to the question of the term over which they should be spread.’

394 Of the balance sheet, Cranstoun (1939, p46) wrote, ‘Note 3 ... describes the policy which the company proposes to pursue with respect to writing off unamortized balance of debt discount, premiums, and expenses in connection with bond issues refunded through the issuance of new first mortgage bonds and debentures: “to amortize over the life of the new first-mortgage bond issue, the presently existing unamortized balance of debt discount, premium and expense together with the pro-rata portion (based upon the ratio of new bonds to the combined new securities issued) of the premiums and expenses (including duplicate interest) to be paid in connection with the refunding of the aforementioned obligations, “to amortize over the life of the new debenture issue the pro-rata portion (based upon the ratio of new debentures to the combined new securities issued) of the premiums and expenses (including duplicate interest) to be paid in connection with the refunding of the aforementioned obligations.”’
worth’ existed. This was a recycling of an idea met in the previous chapter of a ‘third place’. Worman (1934, p368-369) and Douglas (1934, p139) debated presentation issues while Baumann (1936, p383), in answering a question on where particular reserves should be shown on the balance sheet, revealed the continuing confusion regarding a ‘reserve for contingencies’. Saliers (1937, p189) examined published balance sheets and found a lack of uniformity. Advice was still sought in Accounting Questions (1937, p139) about ‘the proper method of reflecting on a balance-sheet’ agreements concerning deferred-payment paper.

Similar questions were posed by Tolley (1937, p301-302). A reply (1937, p302) from the author of one of the original answers was included by the Editor, suggesting the maximum liability that the company could be called upon to meet be stated in the note. The answer is based on ‘the practice of accountants’.

Just what the term ‘contingencies’ referred to in financial statements continued to be uncertain (Cranstoun, 1937; 1937a). This was reinforced by another commentary by Cranstoun (1938, p190) who was surprised to find a ‘reserve for dividends not yet declared’. He later (1938a, p404) commented on the confusion surrounding what was a liability in various cases.

Woodbridge (1938, p105), in analysing the use of the term ‘Reserve’, found that the term ‘reserve’ continued to be applied to (1) asset or valuation reserves, (2) liability reserves and (3) surplus reserves. He questioned the application of the term to the first two groups. Accounting Questions (1938, p67) included a list of credit items, questioning where they might appear on a balance-sheet. The suggested answer allows for alternative treatments of some items. Whether or not a ‘reserve for contingencies’ was an ‘actual liability’ was discussed in Accounting Questions (1939, p373). Inherent ambiguity prevalent in problems here was confirmed in the related answer (p373).

While underlying reasoning was expected in AAA (1936), it provided little towards a definition of ‘liability’ in accounting. It reflected an input-oriented attitude towards accounting as met in Chapters 2 and 3. An income determination process was the central core of accounting, leading to its ‘fundamental axiom’ of accounting being a process of allocation, not of valuation. May provided accountants with a legacy which would last for several decades.

4.4 The May Legacy
The previously met May Committees (and their underlying themes) were successful in part to thwart government intervention in formulating accounting principles or

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395 Paton (1934, p119) wrote varied ‘objectionable practices’ regarding ‘capital and surplus’ included, ‘Failure to distinguish adequately between surplus reserves, asset valuation reserves and liabilities labelled as reserves.’

396 Carey (1969, p40) too comments on successes of the practitioner wing of the profession: ‘In view of the magnitude of the problems to be solved, the temper of public opinion, the lack of any statutory powers vested in independent auditors, and the limited resources and influence of the Institute, its efforts to adjust to the new environment seem in retrospect like trying to bail out the ocean with a teaspoon. But to do them credit, the profession’s leaders kept trying, and in the end, considering everything, they were surprisingly successful.’
rules. They were to protect the accounting profession in general and the practitioner in particular, while taking a step forward in developing AAP and clarification of auditors' responsibilities via negotiations with NYSE. However, to Chatov (1975, p132) they represented the abrogating by SEC of the responsibility to determine AAP. To MacNeal (1939/1962, p69), his underlying criticisms of accounting were dismissed – to him the observed problems of practice were intellectual, not moral.

The nature of accounting and the widespread misunderstanding of its significance and limitations were discussed. The importance was stressed of judgment in accounting and of the earning capacity of an enterprise (as reported in the income statement). The latter was contrasted with the less importance of the valuation of assets and thus the balance sheet (Carey, 1969, p40-41).

Members of the various May Committees were from the practitioner wing of the profession, including Staub who earlier had debated with Berle issues raised in the establishment of SEC. By 1936, May was in a position to claim that the views of the Committees were supported by both NYSE and SEC. As mentioned earlier, the phrase ‘accepted principles of accounting’ was introduced into the working vocabulary of practising accountants. May was of the opinion that such a vague phrase would alert investors to the limitations of financial statements. Indeed, loose terminology might be seen as advantageous to particular stakeholders in selected circumstances.

Loose terminology was further illustrated by May (1943, p42) in the deliberations of the Committee he chaired on the Cooperation between AIA and NYSE. The

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397 On January 21, 1934, the Institute published a pamphlet entitled ‘Audits of Corporate Accounts’ (Zeff, 1972, p125).

398 MacNeal (1939/1962, p69), ‘The main problem is intellectual, not moral. The accounting profession is not corrupt.... The real difficulty lies in the sophistry, illogic and untruth of present accounting principles, which produce figures deceiving accountants, businessmen and the public alike.’

399 For example, the signatories to one document were six members of the Institute committee: Mr. May, as chairman, of Price Waterhouse & Co.; Archibald Bowman, of Peat, Marwick, Mitchell & Co.; Col. Arthur H. Carter, of Haskins & Sells; Charles B. Couchman, of Barrow, Wade, Guthrie & Co.; Samuel D. Leidesdorf, of S. D. Leidesdorf & Co.; and Walter A. Staub, of Lybrand, Ross Bros. & Montgomery (Carey, 1969, p40-41).

400 May (1943, p37) tells of a then (and arguably still found today) ‘not uncommon’ ploy of ‘the accountant who had been unable to persuade his client to adopt the accounting treatment that he favored, to urge as a last resort that it was called for by “accounting principles.” Often he would have had difficulty in defining the “principle” and saying how, why, and when it became one. But the method was effective, especially in dealing with those (of whom there were many) who regarded accounting as an esoteric but well established body of learning and chose to bow to its authority rather than display their ignorance of its rules. Obviously, the word “principle” was an essential part of the technique; “convention” would have been quite ineffective. This illustrates the loose terminology used by accountants, often to their own advantage.

401 May (1943, p42), ‘In the correspondence the Committee had used the words “rules,” “methods,” “conventions,” and “principles” interchangeably. The word “methods” was being used in the suggested form of report in another sense; the word “rules” implied the existence of a ruling body which did not exist; the word “convention” was regarded as not appropriate for popular use and in the opinion of some would not convey an adequate impression of the authority of the precepts by which the accounts were judged.’
practitioner wing of the accounting profession, under May’s guidance, provided accounting with a function with an implicit input-oriented direction. Under this input-oriented process, the calculation of profit for a reporting period was the key issue. This involved a series of steps. First, the amount of revenue for that period was recognised usually at the point of sale (in either a cash or credit transaction). Second expenses for that period were recognised under a matching process in two ways. If an expense could be seen as contributing to the revenue as recognised, it was included in the calculation of profit. If an expense could be seen as applying to a particular period, it too was included in the calculation of profit.

These rules were to lead to deferred credits and deferred debits which were to be carried forward on the balance sheet at the end of that period as liabilities or assets and affected the calculation of profit in future periods. There were exceptions to these rules which included various mining (especially gold) and agricultural ventures and construction over a number of periods of long term assets.

This input orientation underlying conventional accounting meant the income statement was dominant, resulting in a balance sheet which would present a view of the financial position only by chance. This would allow some, including MacNeal and Chambers, to question the idea of truth in financial statements.

Arguments continued on whether a balance-sheet was a true statement of condition as of a specific date. Perhaps, it was argued, it produced only a half truth as a result of over-conservatism. It was suggested that accountants be censured severely or legally punished for being found guilty of over-conservatism as they were for over-optimism or carelessness (Bennett, 1928, p428).

May played a key part in various debates. That with Ripley met earlier on the ‘balance sheet’ saw May’s ideas persevere. Arguably winning that debate, he was to provide major input into the reporting requirements of both NYSE and New Deal legislation first under the control of FTC and later SEC. This influence was all pervasive until the early 1970s.

Prevailing ideas existed that AAP are formulated based on what is done followed by a rationale later of why it was done that way. While some in the academic wing of the profession were more concerned with the why, the practitioner wing via the May legacy, summarized in Figure 4.1, ensured that financial reporting became a process

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402 May (1936, p114) could conclude, ‘Out of this necessity has grown up a body of conventions, based partly on theoretical and partly on practical considerations, which form the basis for the determination of income and the preparation of balance sheets today.’

403 May (1936, p117) concluded, ‘... therefore the income account is usually far more important than the balance sheet. In point of fact, the changes in the balance sheets from year to year are usually more significant than the balance sheets themselves.

‘The development of accounting conventions has, consciously or unconsciously, been in the main based on an acceptance of this proposition. As a rule, the first objective has been to secure a proper charge or credit to the income account for the year, and in general the presumption has been that once this is achieved the residual amount of the expenditure or the receipt could properly find its place in the balance sheet at the close of the period...’
of cost allocation based on the matching of revenues and expenses to current and future periods. This was achieved via the use of 'conventions' which in turn led to the 'principles at the theme level and the 'principles' at the rules level — conventional accounting.

Figure 4.1 May’s Legacy

4.5 Summary and conclusions

During this period, major changes — economic and social — continued. Sobel (1965, p248) pointed out that it 'would be impossible to discuss or even list the names of all the prominent speculators of the decade.' Indeed, some in this group would not meet

404 Green & Moss (1982, p204) conclude, 'In making an assessment of [UK] commerce and industry in the inter-war years, it is tempting to judge the actions of businessmen ... in the knowledge of what came rather than from their own standpoint. Undoubtedly many senior business leaders failed to take a long-term view, largely because after [WWI] they were grappling with difficulties which threatened the survival of their businesses and sometimes industries. Yet even if this interpretation is accepted, it is far from certain that the outcome would have been materially better if business leaders had chosen a different menu of options.'
JP's character-type criteria, large sectors being 'usually unacceptable in polite society during the twenties.' One change was the influence of investors\textsuperscript{405} who were had little interest in power via running a profitable business. Instead, profits from trading in securities set the goals.

This approach was to have serious consequences. The low interest funds available (under the Federal Reserve) and low tax rates from government aimed at, among other national and international goals, providing funds for new tangible assets for production purposes. This in turn would increase employment and the standard of living. However, management of corporations could instead produce higher returns by investing in the call money market. Banks, Wall Street and its brokers also would be borrowers of those funds. While the economy was slowing, incongruously stock prices surged (Sobel, 1965, p256-257).\textsuperscript{406}

\textbf{Argument}

4.11 Publicity regarding financial information continued to be debated.
4.12 Management continued to be given discretion and scope to manage information on income.
4.13 Government policies seeking investment in tangible assets were undermined by economic issues which resulted in higher returns from investment in non-tangible assets.
4.14 Self-regulation by co-operation among private groups is the preferred method of control.
4.15 It is argued that in accounting, commercial/financial needs are distinct from economic needs.
4.16 While at first speculation is seen as cause of economic and social difficulties, later revelations see questioning and criticism of accounting.

Several groups (like IBAA, NYSE and AIA) and individuals argued for improved corporate disclosure standards, especially at the financial level. Congress would consider a number of securities bills but none were enacted. Government was dominated (if not controlled) by business and finance interests and the public was not in a reforming mood. The stock market crash of 1929 and the depression which followed would see that mood change (Hawkins, 1962, p185, p189).

\textbf{Argument}

4.21 The corporation is accepted as a key economic device, tilting the balance away from social issues.
4.22 Issues of form tend to dominant those of quality.
4.23 After the 1929 Crash and the following depression, public mood changes towards the need for legislation.

\textsuperscript{405} Here, 'most of them knew how Wall Street operated, but few had any idea of the nature of its economic underpinning' (Sobel, 1965, p251).

\textsuperscript{406} Sobel (1965, p259, our addition): 'The securities markets of the twenties were, on the surface, in the midst of a genuine [real economic] boom, based on increased production, consumption, distribution, and so forth. Careful analysis shows, however, that installment buying, capital stagnation, faulty corporate structure, unsound banking, untried leadership, questionable financing, and greed born of fantasy led to a bull market which, at its best was a house of cards.'
While some\textsuperscript{407} placed doubt on any criticism made of accounting, others like de Bedts (1964, p27-28), drawing substantially on the Pecora Hearings met earlier, would disagree. While at first the public had been happy with the diagnosis that speculation was the cause of the Great Crash, doubt later arose that other factors might have caused the large public losses in investments. Collapses such as those of Insull, Kreuger and RMSP revealed a callous exploitation of the investor. Financial support had been earnestly solicited by promoters and management, but the discovery that leading USA investment bankers had received huge commissions led to a questioning of the \textit{standards of integrity} of financial leaders who had been revered.

Stockholders and depositors were able to glimpse the utter lack of fiduciary responsibility exercised by firms speculating with funds entrusted to them. While the stock exchanges insisted on their detached roles as the mere reflector of basic supply and demand, many questioned whether the market forces operating were as impartial as depicted.\textsuperscript{408} The quality of the accounting was in doubt.\textsuperscript{409}

A major social and economic change to influence accounting was certainly the creation of the SEC. It alienated many financial leaders in general and accountants in particular. However, its first Chairman, Kennedy, took a moderate line, arguably for FDR to show his administration did not seek to destroy capitalism. This was essentially followed as well by Landis, the second Commissioner. Broad regulatory programmes were not sought until 1937 under Chairman Douglas.\textsuperscript{410}

The self-regulation issue was keenly fought by business and accounting interests. Whitney again led those in the first group who argued there was no need for reform. However, their case collapsed when dishonesty in high places was again found.

\textsuperscript{407}Dillon (1977, p305) concluded the data from his review of ‘accounting practices’ in the 1920’s illustrated some deficiencies in accounting practice, especially when compared with the then current ones. ‘However, these deficiencies were not nearly as important or extensive as is widely believed. A review of the data reported here does not support a conclusion that accounting practices in the 1920’s were culpable in the stock market crash of 1929.’ (This is restated in his Conclusion, p334-335).

\textsuperscript{408} Similarities are found with revelations related to actions of investment brokers and bankers after the 2000 dot.com collapse and post-Enron in 2001.

\textsuperscript{409} The approach to reform during this period (and probably still now) is well summarised by Withers (1930, p61), ‘Schemes are periodically produced for balance-sheet reform, and discussions of some system by which company accounts could be brought into closer connexion with veracity are a hardy annual.’ There was much discussion, but arguably little action, especially as regards the quality of the accounting information. This issue arises repeatedly in debates introduced as this study proceeds. For instance, Kohler (2005, p45) writes of the Sons of Gwalia recent collapse, ‘But perhaps the most astounding thing about the report is that the auditor, Ernst & Young, missed everything. ... This almost always comes up after companies collapse, and the auditors complain that too much is expected of them and that they don’t have eyes in the back of their heads... [The] administrators are alleging that for five years, year after year, the auditors signed books that had been cooked.’

\textsuperscript{410} By that time, arguably it was too late for what would be seen as revolutionary changes (Sobel, 1965, p300-301). Indeed, the SEC and its powers would continue to be challenged; see Benston (1976, p497), ‘Consequently, were I asked, I would recommend that the United States move towards the U.K. system by reducing the authority and power of the SEC. The concept of “disclosure” should be restated to make it clear that the SEC is primarily an agency to which corporations report what they have disclosed to shareholders and how they determined the numbers rather than an agency that determines what and how corporations must report to the public.’ See also Blough (1937); Weiss (1976).
Whitney was found guilty of grand larceny and jailed. When this was followed by the McKesson & Robbins fraud and its accounting scandals, demands for more regulation were made. Douglas would oversee any changes. However, his successor would support cooperation among groups (Sobel, 1965, p305-307).

Argument
4.31 Limitations of the output of accounting are stressed under May Legacy.
4.32 Technical meanings and conventions adopted in accounting.
4.33 Under May Legacy, non-accountants are to be educated regarding matters like these.
4.34 Under May Legacy, personal qualities are seen as the solution of problems in accounting.
4.35 Some like MacNeal argued the problem was not a moral one but an intellectual one.
4.36 Findings from investigations into collapses see mood for legislation including that on accounting, strengthened.
4.37 The income statement is deemed the dominant statement.
4.38 Tension grows among those in the practitioner and in the academic wings of the profession.

The situation at the end of the decade saw an SEC, with extensive authority from Congress to establish rules to be followed in reporting by corporations. Instead, as May argued, AAP were developed and directly administered by the accounting profession. Until the 1970s, words like rules, methods, conventions and principles were used interchangeably. Related tensions would be found regarding liabilities.

Argument
4.44 Liabilities continued to be debated mainly at the application level, though some in the academic wing related sought underlying reasoning.
4.45 Debates on liabilities included issues of definition and monetary amount.

This state of affairs is consistent with the ideas underlying conventional accounting.⁴¹¹ That this situation continued is shown in the next Chapter, although questioning and criticism of conventional accounting grew.

⁴¹¹ Arguably, little seems to have changed. Notwithstanding the ‘principles versus rules’ rhetoric of the new millennium (AAA, 2003; Largay, 2003; Schipper, 2003; Nobes, 2005), it may be interpreted that these words continue to be used as synonyms.
Chapter 5 The Framework: Corporate Governance in the Twentieth Century

From World War II to the 1960s – The Dominant USA Influence

Yet the fact appears to be that the dangers inherent in corporate international relations are much the same as those inherent in any kind of international contact. Attacks are frequently based on the analogies of history: the conduct of affairs by the British East India Company, or by American concessionary companies in the Caribbean has been transposed from the eighteenth and the nineteenth centuries into the twentieth, and has been superimposed as a sort of stereotype picture. This would be about as factual as analyzing twentieth-century democracy on the basis of labor conditions tolerated and accepted by Great Britain or the United States in 1835.

But if many attacks have been meretricious, defense has been almost equally inept. Most corporations shroud their international arrangements in deepest secrecy.


The standards for judging the long-run adequacy, from the point of view of the public, of management’s financial disclosure practices are set, explicitly and implicitly, by the needs – past, present and anticipated – of the numerous and diverse articulate users of financial statements including the so-called critics of big business. These groups, of course, exist externally to the firm. In general, these standards are shaped primarily by the user’s objectives, social values, and expectations – rational and irrational – as well as the general political, economic and social environment.


5.1 Introduction
In the previous chapter, it was concluded that under the May Legacy, conventional accounting with its practitioner emphasis, was the dominant basis for accounting. While agreeing that this approach did have a limited use,412 others continued with debates at various levels.

In this Chapter, the period of WWII and its aftermaths are discussed (5.2). Included here are Whitney’s (1940) responses to May’s arguments. To Whitney, ‘traditional accounting’ and May’s conventional accounting had become synonymous.413 Next,

412 Whitney (1940, p308), ‘Traditional accounting procedures are sound, because accounts based on cost ... comply with the equitable doctrines governing reports of fiduciaries.... Balance-sheets prepared to traditional standards constitute part of the accounting corporation managements should render to shareholders for use and care of shareholders’ funds. Although the courts have not classed corporate managements as fiduciaries, their responsibilities and duties to shareholders are actually fiduciary in character. The amounts shown opposite items of fixed assets on balance-sheets should be based on cost because they are accounts of expenditures.’ The reference to fiduciaries suggests a stewardship/trustee influence. Indeed, similar references are found to this day in Australian statutes regarding companies. The traditional balance-sheet may be useful in the stewardship role. It could easily incorporate ‘cash in’ and ‘cash out’ as well as legal debts of the entity.

413 Many years later, Clarke et al (1997, p122) would argue in a similar vein suggesting ‘along with the privilege to make bad decisions, it is everybody’s right to expect accounting to “tell it how it is”, rather than mask the financial facts with the “jiggery-pokery” of the kind which conventional accounting passes off as sophisticated (though mysterious) financial representation ... Conventional accounting and auditing practices, by their very nature, provided a vehicle for public deception.’

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the Australian context in which Chambers first wrote is outlined (5.3). Finally, a summary and conclusions are presented (5.4).

5.2 World War II and post-developments
As happened after WWI (3.3), this period too provided impetus for major social and economic change (Wilcox, 1945; Previts & Merino, 1998, p298-301). The New Deal (4.3) was replaced by WWII as the major topic of conversation. War orders strengthened the economy, corporate profits rose and unemployment fell. However, the mobilization of the economy consumed so much of national income (especially when compared to that in WWI) that tighter controls and higher taxes than ever before were required. Consumers, rather than investing in shares, used surplus cash to reduce debt and increase savings. At the end of WWII, preconditions of a boom were present, but scars from the 1920s and the depression stayed individuals’ hands (Sobel, 1965, p310, 313-315).

After WWII, the Truman administration continued with high taxes, wage and price controls, leading to some social unrest. At the economic level, prosperity continued though many expected another major crash (as had occurred after WWI). A major political issue of the time was the Cold War (Sobel, 1965, p316). To some, surprising comments on publicity/disclosure of financial information were included in an Editorial (1947a, p186) which argued management was to make public all information about a corporation. This was to be in a context of a free-enterprise market system in which corporations would play a major role in the community. Perhaps FDR’s ‘Truth in Securities’ statutes were now bearing fruit.

As well, the Dow Theory had gained sway. This was built around movements in the Dow Index and various levels of resistance. Caution was the prevailing sentiment (Sobel, 1965, p316-317). Despite good economic data, a bull market failed to eventuate. Higher earnings reported in financial statements simply meant lower price/earnings ratios.

Certainly, USA capitalist system continued to revolve around the operations of a relatively few very large corporations (Previts & Merino, 1998, p301-302). Pivotal industries were concentrated in a few corporate units. Society in turn had profited materially. Large-scale production and mass distribution were carried on by a system for which these large institutions could justifiably claim a share of credit. USA life had changed as poverty had been reduced to minimal proportions relative to that found elsewhere in the world (Berle, 1954, p28-30).

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414 Editorial (1947a, p186, first “omitted in original), “This is the period of limelight for the affairs of American industry. The era of cover-up and kill-the-story is dead. The public wants the facts laid on the line and it’s up to us to deliver the goods. The time has come for us to expose every feature, every salary, every cost, and even all the dirt in our business to the American people.” Did this statement come from a labor leader, or a Communist? No indeed. It was made by Frederick C. Crawford, president of Thompson Products, Inc., and former president of the National Association of Manufacturers ... The statement is a manifestation of a new spirit in American business — a realization that attacks on the free-enterprise system cannot be defeated by silence or secretiveness about the affairs of business corporations. The public can hardly be expected to appreciate what these corporations do for the community as a whole, unless adequate information is readily available.”
Truman’s unexpected victory in the 1948 Presidential elections was a blow to those expecting a pro-business administration. Still, some industries did present investors with bull conditions, especially those in new areas like television and air travel. However, the Korean War (and a potential WWII) saw a financial slump despite continued good economic data (Sobel, 1965, p322-325).

Eisenhower’s pro-business pledges and 1952 presidential victory saw a brief surge on Wall Street. However, various deflationary policies led to declines in economic indicators. Ironically, it was during this time of bad economic news that the seeds for the bull market of the late-1950s were sown (Sobel, 1965, p326-327); coincidentally, the ideas of Chambers’ CoCoA were being forged.

Further development of ‘people’s capitalism’ also occurred during this period. Gross (1996, p96-105) relates this development in his chapter on ‘Charles Merrill and the Democratization of Stock Ownership’. Others were a little more circumspect of Merrill’s place in financial history. It is conceded that his sales people and their messages were backed by a large research department and chicanery seemed much less than in earlier periods. Despite claims of ‘people’s capitalism’, individual shareholders were still scarce in total population terms (Sobel, 1965, p334-340). However, some easily applied rules were now accepted in making investment decisions. One such rule was based on the price-earnings ratio which in turn led to a continuing and increased emphasis on the calculation of income to allow valid intercorporate comparisons. However, the principles and practices underlying that calculation were still regarded with much caution.415

Arguably, New Deal policies had led to a mixed system being developed in which governmental and private property were inextricably mingled. Some argued this was creeping socialism; others viewed it as a direct consequence of galloping capitalism (Berle, 1954, p109).

Berle (1954, p128) found the debate somewhat sterile, as the greatest difficulties faced at the social level concerned agreements covering economic ones.416 Any government, capitalistic or otherwise, faced difficulties in respect of handling production, distribution, and international trade when run by large, powerful corporations. As Morganization (met in Chapter 3) and the history of the Sherman

415 See for instance the work of the AAA further analysed in 5.2.3.

416 Berle (1954, 129-130): ‘European thinkers accordingly saw the question somewhat as we are posing here: a problem of power. Locking all the power in a single, world-directed empire, was quite satisfactory to a Russian Communist or to a Nazi statist – always providing that the power came to rest in his particular party or group. The socialist came to somewhat the same conclusion though he was prepared to allow a much higher degree of self-determination to individuals within the system of planning as he conceived it. Hardly anyone cared to assume the risk, in twentieth-century Europe as it actually exists, of unplanned industry: the danger was too great that political forces engendered would create conditions under which industry would sharply contract, and some of it might disappear. This meant risking unemployed workers, failure of supply of consumer goods, deterioration of the standard of living, possible political disorder, in brief, a step backward in civilization - the kind of backward step in fact that no American politician would risk for a moment if he were faced with similar choice. Unless therefore the European could somehow eliminate all barriers inherent in national boundaries, securing a single market, including many countries, he was unwilling to take the risk.’
anti-trust law in USA show, corporations had to be prevented from market-controlling understandings among themselves.

Berle (1954, p179-180) foreshadowed a major change in thinking when the modern corporation would be seen as a social institution. Management was delegated responsibility for dealing with not only the corporation's financial assets, but also other non-financial resources. Management was (and is still) required to develop a broad range of skills to meet decision-making criteria. These include the nature and scope of not only accounting functions, but also other disciplines in the context of decision-making in a particular marketplace and related reporting to stakeholders other than shareholders.

Requirements included a strong grasp of the nature and scope of the finance and accounting functions in the context of how a particular firm operates and adapts in a particular marketplace. At the same time, the legal models underlying CG had further evolved. Some models with a common law influence emphasised general principles to guide practices within which professional judgment would have a place. Other models with a code law influence stated rules for all cases in practice. The former tends to emphasise principles and have a strong market orientation. The latter tends to be based on many and lengthy rules with a strong government or public sector orientation. Tensions between models would continue to be debated to the present day (Nobes, 2005, p25-26).

Analyses of corporations expanded into new disciplines. While legal issues were dominant in earlier times and while in the 1920-30s corporations were analysed as economic institutions, now they were to be studied as quasi-political (or, as classified in this thesis, social) institutions as well (Berle, 1954, p5).

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417 Berle (1954, p179-180), 'We have thought of it merely as an enterprise (or perhaps combination of enterprises) within a community. American political thought has been frightened, and corporations themselves have been frightened, at any suggestion that they might emerge as political institutions in their own and separate right. So we have not been accustomed to place over against each other, as necessarily interrelated facts, the pragmatic concept of the corporation and the philosophical concept of the desirable community. Corporate executives rather resent being assimilated to politicians; still more they resent being called to account by philosophers. They belong to one of the few groups in history to which political power came unsought, or at any rate as a by-product rather than a main objective. It is probable that when [Curtice and Sloan, Jr] wrote in General Motors Annual Report for 1953, that "with the elimination of controls and with the trend away from a centrally managed economy, industry is possessed of the opportunity to make its maximum contribution to the forward march of our country," they did not think they were talking politics at all. Still less, perhaps, would they consider they had assumed in substantial measure the philosophical burden of judging what is and what should be the "forward march" of a very great country. But they had done just that.'

418 Staubus (1977, p7) points out, 'Managers are experts at achieving goals. They are expected to utilize whatever tools they can command in order to reach their objectives. If accounting principles can be used in a manner that will contribute to their objectives, they can be expected so to use them.' Arguably, the scene was being set for the usurping of the setting of accounting principles/practices by management from the practicing accountants (Zeff, 2003, p280).

419 Arguably, this is seen in the work of Pacioli - rules to solve any problem met in practice (recall 2.3).
5.2.1 The UK scene

Doubts about UK military strength in the early days of WWII (and a strongly isolationist USA) meant volatile markets and financial depression were found. However, events with accounting interactions did occur (Sobel, 1965, p311-312).

In 1942, ICAEW took some ‘professional action’. It established the forerunners of research committees\(^{420}\) and commenced publishing ‘Recommendations on Accounting Principles’ (RoAP). These were seen as statements of best current practice and were not binding on members (Hein, 1978, p82; Aranya, 1979, p269; Nobes & Parker, 1979, p199-200). There arose potential conflicts of interest to be faced by the profession. Willmott (1986, p556) suggests the theme was of professional associations primarily to define, organize, secure and advance the interests of members. If this is commonly held, it certainly leads to potential tensions among groups (West, 2003, p21). As well, tensions were growing between two groups in the practitioner wing – those in practice and those in industry (Noguchi & Edwards, 2004, p312).\(^{421}\)

During this period, the Cohen Committee (1943-45)\(^{422}\), the precursor of the 1948 Companies Act, was established. Among other things, it investigated the problem of secret reserves (recall 4.3.2) as an integral part of the overall problem of classification and valuation of balance sheet items (Cohen Report, para101). Again, organized accounting bodies were to testify (Cohen Report, p164-170; Hein, 1978, p353-354; Nobes & Parker, 1979, p199). The organized accounting bodies reversed their previous stand against secret reserves, in line with the trend of popular opinion against such reserves for the ordinary business company. Certainly, witnesses favoured greater detail, better classification, and better methods of valuation of balance sheet items.\(^{423}\) Two methods of valuation were recommended: cost less depreciation and valuation less depreciation (Cohen Report, para105). Uniformity was still being sought (Hein 1978, p223-225; p229).

Witnesses before the Committee recommended the compulsory circulation of the profit and loss statement. There was, in fact, relatively little testimony in opposition to this position. One opponent, the Committee of London Clearing Bankers (Edwards, 1980a, p177-178), based its opposition on issues like the national interest being threatened by disclosure to competitors or the confusion caused by the often conflicting practices of accountants (Hein, 1978, p255-256; Walker, 1978, p116).\(^{424}\)

\(^{420}\) Noguchi & Edwards (2004, p314) suggest research committees in UK were on occasion ‘given logically impossible terms of reference.’

\(^{421}\) Noguchi & Edwards (2004, p312), ‘In 1942, the ICAEW was unwilling to grant industrial accountants a place on Council, but the creation of a committee on which they had approximately equal membership went some way towards satisfying their claims for a voice in the ICAEW’s decision-making processes.’

\(^{422}\) Cohen Report extracts are found in Edwards (1980a, p126-212).

\(^{423}\) Aranya (1979, p269) claims this period was to see the weakening of the argument from management that publicity was against investors interests as it helped competitors.

\(^{424}\) Indeed, witnesses Messrs. H. Wynn Parry and C. W. Turner complained: “The trouble is that the practice of accountants differs and in so many cases their ingenuity is mis-directed to the withholding rather than the disclosing of information ... that on the whole we are reluctantly of the view that it would be better to leave the whole matter alone.” (See Hein, 1978, p256).
However, a sharp divergence of views was found on the actual items to be disclosed. Some sought disclosure of the components of the trading account - often a most jealously guarded secret. Others argued the statement should begin with the gross profits on trading. The amount of detail sought varied greatly (Hein, 1978, p261-265).

As regards consolidated accounts, by 1944 the trend of opinion had clearly changed from opposition (recall 4.4.1) to support of expanded disclosure (Cohen Report, para122). Non-accountant segments of the business world also solidly supported a requirement for some form of group accounts, preferably consolidated statements. The accounting profession reluctantly agreed (Hein, 1978, p293-294; Aranya, 1979, p269).

The views of ICAEW (1952) on the function of a balance sheet continued to prevail (Cohen Report, para98). It remained an historical document which did not normally show contemporary prices – it was a statement of net worth by chance only.

Green & Moss (1982, p213) link to the RMSP case (4.2.1)425 changes under the 1948 Companies Act, including:

- compulsory consolidated accounts for groups,
- group members were, where possible, to report on the same day, so making window-dressing operations difficult,
- a distinction between reserves and provisions,
- both reserves and provisions clearly stated,
- an explanation of depreciation policy, and
- the prohibition of cross-shareholding (unless expressly permitted by the Board of Trade).

The Companies Act of 1948 expanded the accounting provisions required by previous Acts. Greatly augmented were the items to be included in the balance sheet and those to be included in the profit and loss statement specified (Hein, 1978, p78; p139; p270). It prescribed that an annual report should include a balance sheet and a profit and loss account to disclose a ‘true and fair view’ of the ‘state of affairs’ and ‘profits’. Most accounting requirements of the Act remained consistent with the ICAEW’s previously published rules. Indeed, de Paula recommended that the financial statements be ‘properly drawn up in accordance with accepted accounting principles consistently maintained so as to exhibit a true, correct, and complete view of the company’s affairs and of its revenue transactions’.426 However, that view, along with a suggestion like Whitworth’s (recall 4.2.3) of a statutory set of uniform accounts, was not accepted (Hein, 1978, p175-176; p348).

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425 Green & Moss (1982, p213), ‘When legislation was introduced in the 1948 Companies Act, it outlawed most of the financial techniques employed … in shaping the [RMSP].’

426 This was in appearance before the Cohen Committee where F R M de Paula was described as ‘industrialist and Chartered Accountant’ (Minutes, App MM, para114, p568). His lengthy submission is found in Edwards (1980a, p194-206).
Discussion occurred as to whether assets were to be neither over- nor under-valued, a recommendation being to make this a responsibility of the auditor, especially in instances of take-overs (Hein, 1978, p177-178). As well, pension programmes continued to grow during the period, developing into huge enterprises with large amounts of funds to invest (Hicks, 1965, p93-104). Using the skills and expertise of financial analysts and other investment specialists, the demand for information increased. However, further improvements in disclosure would still take time (Aranya, 1979, p269).

5.2.2 Accounting interactions
The May Legacy would see the practitioner wing of the profession continue to support the adoption of **conventional accounting** as the reasoning underlying financial statements. Certainly, the function of those statements as control devices of CG received less emphasis as other matters took precedent. Tensions continued at various levels.

During this period, the argument that the balance sheet was a statement of financial position was rejected, even though some argument was found on providing more useful and logical outputs.\(^{427}\) Instead, a technical meaning continued:

\[ \ldots \text{a balance sheet is historically a summary of balances prepared from books of account kept by double-entry methods.} \]
\[ \ldots \text{In this view a balance sheet may be defined as: A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of books of account kept according to principles of accounting...} \]

Support continued to be provided over this period (May, 1947, p100-101; Myers, 1948, p289; Graham, 1949, p26). Others, however, were critical of the state of affairs (Caffyn, 1948, p150; Paton, 1949, p51).\(^{428}\)

Criticisms were encapsulated in Whitney’s (1940) argument which raised various questions of the serviceability of the conventionally prepared balance-sheet. These included whether an accountant, engaged in preparing a balance-sheet under conventional accounting, prepared a statement of assets, liabilities, and net worth. He doubted whether such a statement could be reconciled with the title ‘certified balance-sheet’. He saw tensions caused by ‘a great deal of honest difference of opinion about the comparative merits of accounts based on cost and accounts based on appraisals’ (Whitney, 1940, p294-295).\(^{429}\)

\(^{427}\) Accounting Terminology Bulletin No 1 (1953, p11-12), ‘Since ...1941, ...there has been marked progress toward greater logic and usefulness in what nevertheless still are referred to as balance-sheet presentations. It may be that at some future date the term balance sheet will cease to be used to designate a presentation of financial position and will instead be deemed to refer (as the term trial balance already refers) to a mere step, or point of arrival-and-departure, in preparing such a presentation.’ Blackie (1947, p199-200) argued for a change to perhaps ‘accounting position’, ‘statement of stewardship’ or ‘stewardship position’.

\(^{428}\) Caffyn (1948) wrote of Pacioli’s treatise ‘probably causing half the troubles confronting accountants’, of strange credits, of a lack of understanding among clients and of a need for a new series of reports. Paton (1949) was critical of the balance sheet being ‘reduced to nothing more than a collection of unabsorbed debits and credits, bookkeeping balances ... ’
To Whitney (1940, p299), for most modern corporations, balance sheets were not reasonably accurate statements of assets, liabilities and net worth. This state of affairs caused tensions in relationships with SEC which suggested (for selected corporations) the requirement to lodge the balance sheet be eliminated - to Whitney an unsatisfactory result. Both investors and practitioners would suffer, though for different reasons. Investors needed a financial position statement.

Whitney was also critical of attempts to ‘educate’ the public on the technical nature of the conventional accounting balance sheet. He (p301) argued that misunderstandings by investors (that balance-sheets are not what the form, date, and captions seem to indicate) required accountants to tell the public what balance-sheets are. A substitute was required for the meaningless, stilted phrase ‘balance-sheet’. Chambers and others would return to this theme in later decades.

Whitney (p308) concluded that a balance sheet (including fixed assets) based on cost did provide part of an accounting by corporation managements to shareholders for use and care of shareholders’ funds. He saw corporate managements’ responsibilities and duties to shareholders as fiduciary in character - an argument consistent with a narrow view of stewardship for expenditures.

Arguing that many investors believe balance sheets are statements of assets, liabilities, and present net worth, Whitney (1940, p308) proposed the introduction of an additional statement – arguably one of financial position - expressing corporate assets, liabilities and net worth at the independent expert opinion of the value.

Whitney’s (1940) arguments were the source of an Editorial (1940, p389) which suggested he had resolved questions on:

- the debate on all-purpose balance-sheets versus a series of single-purpose ones,
- the valuation or historical cost debate,

Healy (1938) was drawn upon to illustrate the case for cost and MacNeal (1939) for non-cost. MacNeal had more in common with the use of market exit prices rather than appraisals. This key difference is returned to in Chapter 8.

Whitney, (1940, p299): ‘The Commission has found an interesting solution. This has been described by the chief accountant of the Commission, ... Wertz, in the following words:”

“In form A-0-1, for corporations organized within two years to engage in the exploitation of mineral deposits, an attempt has been made to overcome the misleading effect of financial statements of enterprises of this type by eliminating the usual requirement of a certified balance-sheet....”

Amputation at the neck will end a headache. Balance-sheets cannot mislead if they are abolished.... Abolition of balance-sheets may satisfy the Commission, but it is an unsatisfactory solution for investors who want statements of assets, liabilities, and net worth, and for practising accountants who earn their livelihood by certifying balance-sheets.'

The Editorial (1940, p389) stated he had ‘most dexterously untangled some of the knottiest of the questions which bother the accounting profession. His answer to them is startling in its very simplicity.’
• the adoption of Paton and Littleton (1940) theory on the dominant concern of 
  accounting being not valuation, but the periodic matching of costs and 
  revenues,
• the accounting profession's public-relations efforts which explain to the 
  public that terms used in balance sheets do not have meanings commonly 
  ascribed to them.

The answers to the questions (despite being lauded in the Editorial for their 
simplicity) were not to end debate. Indeed, debates continued to seem unresolvable.

In response to comments from Cross (1941), Whitney (1941, p356) restated his 
support for a balance sheet under conventional accounting as part of a narrow 
stewardship function. Others remained unconvinced. Dohr (1941, p201) revisited 
Montgomery's (1919) position (recall 3.3.2) and was critical of this approach to the 
balance sheet. Instead, he argued the mechanics of bookkeeping produced as assets:
• treasury stock,
• stock discount,
• bond discount and
• losses as 'an otherwise rational accountant [seeks] to satisfy this passion for 
  balance'
and included as liabilities
• reserves for self-insurance,
• reserves for contingencies, and
• occasionally reserves for depreciation.

Instead he regarded financial position as basically a matter of financial resources as 
compared with financial obligations. This was consistent with the average man's 
approach. Indeed, he argued the layman was mystified by the conventional balance- 
sheet.

An Editorial (1945, p3-4) continued the debate. A controller of a prominent 
corporation was cited who
• supported a 'statement of financial position' instead of balance sheet,
• attacked accounting uses of the terms 'reserve' and 'surplus', and

432 The Editorial (1940, p389) had included, 'But the unorthodox and unregenerate continue to 
complain that investors are entitled to know current values of properties owned by the corporation to 
which they have entrusted their savings, and - what is worse - that is what they think they are getting 
when they get a balance-sheet...'

433 Whitney (1941, p356): 'Balance-sheets, prepared according to the traditional procedures, account 
for those receipts, expenditures, and accruals, which are not reported on income or surplus statements. 
If... the relationship of managements to investors is quasi-trust, investors are entitled to an accounting 
for all receipts, expenditures, and accruals. This accounting is incomplete without a balance-sheet 
prepared according to the traditional procedures.'

434 Dohr's Note 1 provides a wry comment: 'On the objection to the inclusion as assets of items which 
are not assets the suggestion is advanced that the balance-sheet be regarded as a statement of assets and 
other debits. The headache is thus to be cured by decapitation.'
• favoured a change in **format** to one which reflected total assets less total liabilities equal net worth was suggested, though it was pointed out that some accountants objected to the term ‘net worth’.

However, major indictments included that the balance-sheet conveys a misleading impression of indisputable fact, when the initiated know that judgment and opinion form a large part of it. Also condemned were the loose use of the terms ‘value’ and ‘valuations’.

While commenting similar criticisms and suggestions had been made before, the Editorial (1945, p4) concluded that financial statements needed to be improved by accountants so that the public could more easily understand them. The message was at best ambiguous.

May and his legacy of course had supporters. McMahan (1946, p135) agreed with the use of conventions, though considered new ones might be necessary. His admiration of May was obvious. Cannon (1952, p421) also agreed with May’s approach.

Some were simply happy that changes had been incorporated. Mackenzie (1947, p17) argued AAP for dealing with costs, revenues, assets, liabilities and proprietorship were no longer dependent on the accounting equation and double entry as accounting data could be kept on memorandum records. He agreed with Montgomery’s (1919) argument (3.3.2). Work on AAP of course also required related work on the terminology used. By then this had a lengthy, though chequered, history.

Others were satisfied with the output. Littleton (1952, p171) argued the recording and reporting of historical or invested cost were a consequence of a stated responsibility where an accounting was required. This service (limited to a narrow stewardship one) was a simple necessity and did not arise from convention or tradition.

However, the primacy of the income calculation was leading to further tensions. Some remained unhappy with the output under **conventional accounting**. Others were

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435 Editorial (1945, p4), ‘The importance of accounting arises largely from its ability to convey information about corporate affairs to great numbers of interested persons who are not in a position to get it for themselves. The easier financial statements are to understand, the better the public will like it. It is wholly proper that accountants take the lead in attempting improvement.’

436 McMahan (1946, p135), ‘[May’s] principal theme, variously presented and repeated, is that accounting is largely a body of business conventions, many of which are out-worn and in need of betterment, retirement, or replacement. He likens accounting to the common law in its development and slow yielding and flexing of the needs of society. But, while he believes this characteristic to be the principal principle of accounting, he is impatient with its stare decisis - standing by precedent.’

437 McMahan (1946, p135) wrote, ‘No one, I think, has read Mr May’s Twenty-Five ... and/or his more recent Financial Accounting without stimulation and thrill to those broad, heavy, but nimble, strokes with which he paints his long experience in public accounting.’

438 Cannon (1952, p421), ‘Accounting ... is utilitarian. It is a language and a system of measurement. It is a body of convention and procedure and not a body of logic. Language is conventional and measurement is procedural.’
with definitions in accounting and their meanings. May (1942, p35) wrote, regarding the work of the CAT, 440 of the need to ensure any findings were consistent with the work of CAP which emphasized that AAP were founded on utility, not abstract theories or logic. To May, the solution rested on experiences from practice. Recognizing a demand for the development of a harmonious body of AAP, he (p35-36) saw

\[ \text{a substantial advantage in defining balance-sheet, assets, and liabilities so as to coordinate terminology with rules and principles as from time to time established. This procedure has the further advantage that the definitions establish criteria for determining not only whether a thing is an asset or a liability, but if so in what amount.} \]

A key argument implicit here is that in conventional accounting, issues of definition and measurement seemed inherently linked.

The ideas/issues met in Chapters 2 to 4 certainly influenced debates on terminology which were to continue.441 May (1942, p36) conceded that the layperson would understand accounting terminology in simple cases only. However, the need to apply special techniques and conventions made others more complex. From this he concluded that general definitions in accounting required to be framed within 'a highly technical and in part conventional art'. The public and the profession needed to appreciate that the definitions were technical. This provided a raison d'être for the need for professional accountants.

May agreed with Kester's (1940, p443-444) argument that the public required educating as to accounting terminology. Terms were used in a technical manner. His solution was to highlight the phrase 'in accordance with principles of accounting consistently maintained'. That was seen as sufficient to meet any responsibility in reporting, provided any change by management in accounting practice and its significance is made known.

Neureuther (1946, p158-159) sought attempts to simplify accounting statements so that they were more understandable to readers. While he saw this commendable, he argued this might compromise the accurate and full disclosure of financial operations and condition especially in complex situations.442

439 Dean (1951, p185, emphasis added) argued, 'Profits must be measured differently for different purposes, and the kind of measurement that is needed for executive decisions is not provided by the conventional income statement. The Bureau of Internal Revenue, the stockholders, and the banks, all want special kinds of information, and generally have custom-made income statements designed to fit their requirements.'

440 May (1942, p35), 'Its decision to present definitions of balance sheet, asset, and liability in terms of accounting rules, principles, and procedures was reached after mature deliberation by its members and the research staff....'

441 See for instance Blackie (1947, p193), Editorial (1947b, p183) or Galanis (1947, p368).

442 Neureuther (1946, p158-159) concluded, 'Illegible balance-sheets are valueless to their readers, but oversimplified balance-sheets may be worse than valueless; there half-truths may mislead.'
To add fuel to the fire, Staff of the Journal (1947, p487), after reviewing a survey by the Opinion Research Corporation for the Controllership Foundation, suggested that accounting statements might as well be in Sanskrit so far as any effective communication between business and the public is concerned. The survey found

1. most of the public either does not see, or does not understand, information prepared by accountants; and
2. such information as it does see, it doesn't believe.

Others would support the use of vernacular meanings. Whitney (1941) stood by his required use of non-technical language in reports which would see the balance-sheet including ‘value’ rather than historical cost. Dohr (1941, p205) argued that obviously a distinction was made by the layperson between conventional accounting and factual information. Implicitly, it was argued that a concession to expediency had driven a wedge between accounting and financial facts.

Werntz (1941, p318-319) too commented on tensions arising in the average person’s comprehension of the basic accounting terminology used. This presented a dilemma. While popular usage lacked precision, if financial statements were for general consumption, connotations popularly attaching to many words were to be considered. He questioned whether accountants should redefine a term to suit peculiar accounting needs. Arguably, to do so would heighten rather than dispel bewilderment.

Tensions were reinforced when an Editorial (1945, p3) commented that financial statements were ineffective as the untrained reader had difficulty in understanding them. One reason was that ordinary words were used in extraordinary senses. Debate continued on the possible misleading of the public by the terms used when an Editorial (1946, p275-276) referred to a questioning (by one Knowlton) of accounting using peculiar meanings which were fundamentally different from that

443 Of course, no offence is or was intended to readers of Sanskrit.

444 It was claimed (p3), 'The severest critics of financial statements are accountants. Several years ago the American Institute of Accountants committee on terminology made a clear breast of the verbal faults of accounting....'

445 This Extract (1946, p147) appears in the Journal:

Accounting Terminology and Financial Statements

'Accountants, like lawyers, cling to certain well defined, accepted phrases because those phrases have, to them, definite accepted meanings. They are like chemists, who use chemical formulas because these represent a universal language to them. But it was designed only for other chemists.

'Financial statements are no longer company property. They go to millions of stockholders; they go to senators and representatives; they go to labor leaders; they go to newspaper columnists; they go to college professors.

'It is imperative that accountancy terms be not only translated into layman's terms but be so stated originally. Unless and until this be done, neither the public nor our legislators will understand corporate finances, and the end of the road may lead to the socialization of industry - and of banks.

'From "The Semantics of Financial Reports", by Don Knowlton in Trusts and Estates for June, 1946.'

The Editorial (1946, p276) commented, 'Accountants will welcome Mr. Knowlton's suggestion that a meeting be arranged of representatives of banks, corporations, and certified public accountants for the purpose of simplifying and clarifying the terminology of financial statements. The accounting profession has already developed recommendations which would cure most of the faults which he deplores. What is needed is sufficient popular support to put these recommendations to wide use.'

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generally ascribed to them. As well, the convention that in the balance-sheet, assets are exactly equal to the liabilities conveyed to the layperson an incorrect impression. It was suggested the balance-sheet be replaced by a different financial statement to include a remainder after deducting liabilities from assets – the net worth idea.

At the practitioner level, Editorial (1946, p276) commented that even CAT found inconsistent use of the terms ‘value’, ‘assets’ and ‘liabilities’. Some argued accountants gave ‘far too little attention to particular concepts in [their] general scheme’ (Nelson, 1942, p132).

As regards experiments (primarily aimed at employees and small shareholders) to simplify income accounts and balance sheets by using non-technical terminology, Galanis (1947, p368) found them commendable. However, the analyst with a working knowledge of accounting still required detailed or technical statements criticized any policy of over-conservative or under-conservative accounting. Others like McLaren (1948, p383) would lament that a veritable hodge-podge of financial accounting terminology in company reports was being produced by financial and public relations officers and advertising specialists.

During this period, tensions were not eased by AAA’s two revisions of the reasoning underlying accounting practices. Events and comments subsequent to the publication of the 1936 Statement (see 4.3.2) led the Executive Committee to revise the statement of AAP. As shown in Figure 5.1, the form was little different from the previous statement.

Similar ‘fundamental propositions concerning the functions of accounting in respect to cost, revenue realization, income, and capital’ (AAA, 1957, p51) were considered. The same basic presumption was made (p52) of the reader being a person with a moderate knowledge of accounting.

Emphasis on income measurement continued. Once again, elements are not explicitly defined but rather by means of stating items to be included or excluded from a particular class.

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446 This was based on, ‘Students interested in details of variations in nomenclature are referred to Accounting Survey of 525 Corporate Reports issued in January, 1948, by the American Institute of Accountants. It is sufficient to note that from the titles of the financial statements down, individual whim appears to be the order of the day.’

447 See Prefatory Note, p51. These events primarily took the form of ‘numerous criticisms’ of the 1936 Statement and attempts by other groups working towards ‘the formulation of accounting principles’.

448 AAA, (1957, p52), ‘No one on casual inspection of financial statements can arrive at a thorough understanding of a corporation’s affairs; but it should be possible for a person moderately experienced in business and finance to examine such statements with the expectation of deriving from them basic financial facts on which judgments may be premised.’

449 Unlike the 1936 Statement, this is not explicitly stated here. However, discussions of cost and cost allocation to periods (Section A), revenue and its realization (Section B) and income determined by a matching process (Section C) provide evidence of this emphasis.

450 Examples are found in the discussion of Revenue, p54-55.
Both the 1936 Statement and the 1941 Revision continued to see accounting as an allocation process.\textsuperscript{451} As well, ‘The Basic Assumption’ in the 1941 Revision (p52-53) hinted at a function of financial statements to help investors or creditors to make ‘dependable judgments’. However, the link here was only implicitly made.\textsuperscript{452}

Figure 5.1

<table>
<thead>
<tr>
<th>1936 Statement</th>
<th>1941 Revision</th>
<th>1948 Revision</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preliminary</td>
<td>Prefatory Note</td>
<td>Prefatory Note</td>
</tr>
<tr>
<td>The Basic Assumption</td>
<td>A: Cost</td>
<td>Assets</td>
</tr>
<tr>
<td></td>
<td>B: Revenue</td>
<td>Income</td>
</tr>
<tr>
<td></td>
<td>C: Income</td>
<td>Revenue</td>
</tr>
<tr>
<td></td>
<td>D: Capital</td>
<td>Expense</td>
</tr>
<tr>
<td>Costs and Values</td>
<td>Liabilities &amp; Stockholders’ Interest</td>
<td></td>
</tr>
<tr>
<td>Measurement of Income</td>
<td>Financial Statements</td>
<td></td>
</tr>
<tr>
<td>Capital and Surplus</td>
<td>8 Supplementary Statements</td>
<td></td>
</tr>
</tbody>
</table>

A Symposium (Kohler, 1942) was held on the Revision.\textsuperscript{453} Kohler’s (p2) discussion suggested tensions between academia and practice were easing, especially regarding terminology.\textsuperscript{454} However, as might be expected from his earlier lengthy work on terminology, he questioned that used in the Revision, as did others (who also debated

\textsuperscript{451} The former (1957, p61) argued, ‘Accounting is thus not essentially a process of valuation, but the allocation of historical costs and revenues to the current and succeeding periods.’ In the latter (p51), ‘fundamental propositions concerning the functions of accounting in respect to cost, revenue realization, income, and capital are set forth briefly.’

\textsuperscript{452} Staubus (1977, p21) comments, ‘Unfortunately, there followed no evidence of a connection between this encouraging position and the principles listed in the remainder of the statement. As of the mid-century, nothing in the literature suggested that accountants both recognized explicitly a user-oriented objective of accounting and looked to that objective in making their choices of accounting methods to apply in practice.’ (Staubus does in a related footnote qualify the claim somewhat, referring to earlier individual contributions regarding ‘uses of accounting data.’ But importantly ‘uses’ are not the same as ‘users’.)

\textsuperscript{453} This included a Foreword by Kohler (p1-2); ‘The Cost Principle’ by Staub (p3-10); Discussion by Paton (p10-19); ‘The Revenue and Income Principles’ by Dohr (p19-27); ‘The Capital Principle’ by Broad (p28-35); Comments by Wernitz (p35-41) and an Open Forum (p41-60). The 1941 Revision was reprinted in full (p60-66) as well.

\textsuperscript{454} Kohler’s (1942, p2), ‘As the years went by the Association’s statement gained increasing acceptance among practitioners. It became evident, however, that the language of the earlier statement ... lacked clarity and precision to others. Besides, with each passing year came a new emphasis to items that had previously received scant treatment; on the other hand, a number of matters demanding attention in 1936 were almost forgotten in 1941.’

153
Kohler also emphasised the adaptive nature of accounting evidenced by the challenge of new ideas, concepts and methods demanding attention. He (p2) stressed the dangers of over-reliance on technical meanings.456

Staub (1942), as the title of his paper indicated, dealt with the emphasis on 'costs'. One of Kohler's new ideas/methods was the debate on the use of First-in-First-out (FIFO) or Last-in-First-out (LIFO) in determining the monetary amount of inventory and the related cost of goods sold. This arose as a way of costing outputs in times of price level rises. In turn, Paton (1942, p17) questioned the need to tie schemes of cost absorption to the history of specific physical units of property and specific transactions. Related methods of cost absorption would lead to tension both among and within groups.

Paton (1942, p18) stated one dilemma causing tension was the argument by some that it was better to match sales with relatively current costs rather than with the older costs. He concluded both arguments had their merits. Under conventional accounting, reliance on historical costs meant the debate was irresolvable. He (p19) did introduce ideas from other disciplines within the context of the FIFO-LIFO debate, referring to external and observable physical facts457 and economic relationships. The argument is certainly consistent with the ideas of Chambers’ CoCoA and Sterling (1976), although it may take a leap of faith to suggest agreement followed on the use of contemporary prices. The use of a transmigration doctrine may be seen as a criticism of conventional accounting.

Paton (1942, p19) also commented on the 'real' profits controversy which he argued confused of income measurement and income administration. The former on measurement is consistent with Chambers’ reasoning. The latter on administration

455 Dixon (1941, p54), 'The section on costs and values has justly been criticized from the standpoint of choice of phraseology, from the standpoint of balance of emphasis, and on the ground that certain problems are not provided for.' Mautz (1941, p66), '... the wording in many cases has been described as vague, ambiguous, and inconsistent.' Kerrigan (1941) agreed.

456 Kohler (1942, p2), '... varying word usages and effects presented this drafting group with its greatest problem. What is referred to as semantics is not often thought of as having application to accounting. But in a statement which is to relate to many persons much of its value may depend on the success with which the problems commonly dealt with by semanticists have been resolved.'

457 Scott (1945, p308) would later argue, 'But when men in their search for truth have turned away from the concrete world of their experience and have concentrated their attention exclusively upon polishing and perfecting their own formulations, they thereby have initiated an atrophy of thin ideas. It was this truth which Bacon had in mind in his declaration that it is the first distemper of learning "when men study words and not matter"'.

458 Paton (1942, p19, emphasis added), 'I grant that you can't always demonstrate that following the physical flow is completely satisfactory from the standpoint of what might be called economic relations and ultimate economic incidence, but to me it is much more satisfying to keep accounts which are in accord with external and observable physical facts than it is to go over to transmigration doctrine.'
suggests income smoothing /earnings management which leads to tensions to this day when flexible AAP are used (Schuetze, 2001, p10-12; The Economist, 2006c, p57).

Dohr (1942, p20) warned of giving primacy to one statement. To him, each part was to be considered in light of its relationship to the whole. As well, he questioned the practice of authors commenting on particular sections of the argument without an understanding of the total argument. Not to do so would see tensions and irresolvable debate, as indeed was found in responses to Chambers’ CoCoA (See Chapter 8).

That tensions were met between underlying theory and application was directly referred to by Gaa (1944, p272). He argued that for some years, AAA, AIA and a few individuals had tried to formulate statements of AAP that could be generally accepted - but none had been. As well, both theory and application were individually beset with tensions. To him, a coherent and consistent system of accounting standards may be constructed only if it is built around the function which accounting serves. This was to be a critical element in Chambers’ CoCoA and his CF ideas.

As might be expected, May (1945, p134) was critical of the 1941 Revision. He questioned the disclosure presentation methods, especially the use of footnotes to the financial statements. He (p135) did agree with the 1936 Statement’s claim that accounting is a process of allocation, not of valuation, but with reservations. One was the omission of ‘tentative’ in the title. He (1945, p136) held other general reservations also. After some damnation with faint praise, he found

459 The Economist, (2006c, p57), ‘Enron’s accounting may have been creative or aggressive - but so, the argument [of the defence] goes, was many companies’ during the stockmarket boom; it was certainly not fraudulent.’

460 Gaa (p272) concluded, ‘Even though accounting theory is in a confused condition, it is far better organized than the rules of contemporary practice.’

461 Knight (1955, p268) succinctly summarizes the tensions underlying criticisms (and perhaps related accounting tensions), ‘What makes economic reviewing (and all criticism, and discussion) difficult is that writers and teachers of standing do not agree on the ABC’s of their subject, the definition of their “science” and its elementary concepts, and the statement of its first principles…. But one cannot appraise ideas without judging men – making “odorous comparisons.” For, in judging another one is implicitly judging oneself, and must leave it to the “gentle reader” to judge where the judgment falls. A reviewer must point out “errors” and try to find their roots, not for the sake of controversy but for the sake of “the cause,” of truth, in this case of education in economics – beginning with mutual education of the educators.’

462 May (1945, p134): ‘The advocacy of stereotyped even though inappropriate methods of presentation, accompanied by footnotes in which the really illuminating information is embodied, was to my mind a serious defect …’

463 May (1945, p136), ‘The omission of the word “tentative” from the description of the second statement seems to me to have been unwise. I regret, also, that the Association in its revised Statement of 1941 discarded the word “allocation”…’

464 May (1945, p136), ‘I regard A Tentative Statement ..., issued by the Association in 1936, as a valuable contribution to the creation of an orderly body of accounting thought, though there are many views expressed in it with which I am unable to agree. Frankly, I regard the more definitive Statement of 1941 as premature and defective in that it largely ignored developments in accounting between 1936 and 1941. I have found the language of different parts of that statement inconsistent and the meaning in
(1) the Revision premature and defective by ignoring recent work done
(for example by CAP) on accounting;
(2) difficulties with the terminology used; and
(3) implications for the FIFO-LIFO debate.

Of course, the last remains unresolvable under conventional accounting.

Other reservations, about which May had strong opinions, were issues which were
simply being recycled. These included:

(1) Was the body of AAP to be rigid or flexible?
(2) Were AAP to be uniform, objective and well understood or conventional,
requiring outsiders to be educated?
(3) What were the potential uses of financial statements and related purposes (or
functions)?
(4) Are single-purpose financial statements achievable?

Indeed, May (1945, p138) would conclude, 'I expressed doubt whether any single
form of statement could serve these purposes even reasonably well.'

On the other hand, Husband (1942, p283) was more supportive. He sought
refinements in particular areas like the links between the fundamental task and related
principles. As regards the fundamental task, after quoting Kaplan, Keynes, MacNeal
and May on the use of accounting information, Husband (1942, p292) made various
interdisciplinary-type comments, noting their message for accounting in the generic
sense. The narrow stewardship-type function, where conventional accounting did
have a function, was under attack. Other functions might be met if tasks and
principles were better linked.

some cases far from clear. Both supporters and opponents of the "cost or market" basis for stating
inventories have claimed support from it for their respective views, and I have never been quite able to
decide which claim was the better founded. [Footnote: cf. Financial Accounting, p180].'

466 Husband (p283): 'The revised statement ... is a decided improvement over the statement of
principles previously published in June 1936. Nevertheless, it still contains spots where further
burnishing would appear to contribute both to desirable refinement and to greater harmony between the
principles and the fundamental thesis upon which they are based.... An attempt will be made, rather,
to point out and emphasize inconsistencies in the principles and to consider the use of terms that may
be misleading when used in connection with the task that historical accounting is designed to
accomplish.'

467 Husband (1942, p293, emphasis added), 'Take your pick, O Reader, and go your way rejoicing for
"you are right if you think you are." Personally, it is my opinion that historical accounting is a sine qua
non of business procedure and that all efforts to improve it are worthy of commendation. To a
considerable extent, historical accounting meets the requirements of income-tax procedure; it keeps
proper records of the relations between the business and its customers and creditors; to a considerable
extent it accounts for the manner in which hired servants perform the duties of their stewardship; it
depicts the success or failure of original owners. I should like to see accounting expand its
serviceability, however, by broadening the scope of the activities. By so doing I believe that it can
become truly worthy of the Committee's assumption that it is of "prime economic and social
significance".'
The AAA 1948 Revision assumed a form different from previous ones. Although included were various 'preliminary considerations' (p13) in common with the 1941 Revision, the structure was a marked change from the previous two (Figure 5.2). Now the components of the balance sheet were discussed under separate headings. In addition, several 'standards for statement presentation' (p17-18) were listed. Of the fourteen given, eleven are in a 'should be' format and one each in a 'should not be', a mixture of 'should-should not' and a 'may be' format. The Revision is supported by a series of eight Supplementary Statements issued from 1950 to 1955.468

The 1948 Revision contained little discussion on the function of accounting. However, accounting was envisaged as a language, a means of communicating data.469 A set of rules or restraints were not intended. Instead a theory to underlie AAP was sought.

Report of the Committee (1948) included Newcomer's (p7-12) 'Introductory Statement'. He (p8-9) reported the Committee found the 1941 statement basically conceptually sound. However, some disquiet was found with the language used. Tension between the academic and practitioner wings remained obvious, as the 1948 Revision implicitly rejected the criticisms made or reservations held regarding the earlier Statements by those like May, other than criticisms of a terminology bent.

Newcomer (1948, p9) referred to the importance of appreciating different levels of abstraction.470 He argued the underlying theory was the key to logical standards or rules. Fundamental ideas needed to be clearly stated. Various approaches were possible, including the empirical, but a deductive one recommended. Again the themes were consistent with Chambers’ approach to developing CoCoA and to the various CF projects that would emerge (Chapter 7). Newcomer (1948, p10-11) also discussed the use of words like law, principles, standard and rule in discussions of accounting. How they might be incorporated within accounting would become a further idea recycled over time in the literature.471

468 These are reproduced in full in AAA (1957, p19-50).

469 It (p13-14) was argued, 'The acceptance by any business organization of the concepts and standards presented here should be viewed not as a submission to arbitrary rules and restraints but as providing an opportunity for interpretation and comparison by means of the common language of accounting.'

470 Newcomer (1948, p9) wrote, 'Consequently, the formulation of a statement of principles is not an attempt to formulate rules or methods of procedure but an attempt to develop a doctrine which will aid in establishing such rules or methods.... The Committee has no authority beyond that of logic and no aim but a clear statement of important ideas fundamental to accounting. The Committee feels its approach to the problem is properly deductive, that is from general to particular. An inductive, or conceivably an empirical, approach may be possible or even feasible but the Committee believes the deductive method more direct and more conducive to the development of a well-defined core of principles and standards.'

471 See ZEFF and Keller (1964, p10): 'Communication between the ... sides is confounded by a terminology that has never been settled in clear and precise terms. Many articles in the literature would never have needed writing had exact meanings been agreed on for such terms as theory, concept, principle, postulate, axiom, procedure, rule, convention, standard, and practice – and these deal solely with methodology and not with the substance of the body of accounting knowledge.'
A Symposium (1949, p44-60) included 'A General Appraisal' (Miller, p44-49), 'Comments on Item 5 under Expense' (Paton, p49-53) and 'A Critique and Comparison with the 1941 Statement' (Taggart, p54-60). The theme was in general supportive.

In discussing the effects of price level changes on the calculation of income, Niswonger (1949, p27) referred to the emphases on 'cost' and opposition to write-ups in 1948 Revision and 1936 Statement. He was supportive of the opposition to write-ups, providing implicit latent support for May's (1948) views.

Others like Borth (1949, p277) and Mason (1950, p133) were clearly supportive of the Revision. The former argued that effects of economic developments over the past seven years on the principal concepts of accounting had been incorporated. The latter found the propositions valid and the Revision a contribution to more effective corporate financial statements.

However, Bedford (1951, p528) warned not all issues had been resolved. He questioned the lack of a specific definition of the nature of income. The generalization 'The income of an enterprise is the increase in its net assets (assets less liabilities)' required more elaboration. He did discuss the definition of asset but not that of liability. He (p530) did mention revenue 'from advantageous settlement of liabilities'.

Vance (1944, p231-232) argued that if rigid standards were set, further progress would be discouraged. As evidence of such a danger he referred to practices found in the adoption of uniform systems of accounts for utilities. While (p236) questioning the adequacy of conventional accounting procedures, he argued views and practices of businessmen required more recognition in the area of accounting theory. As well, he (1944, p237) questioned the use of footnotes to the accounts as they made interpretation difficult, especially for persons not specialists in accounting.

The reporting by large joint-stock companies was found by Claire (1945, p39) to range from

- instances where management used all available talent (including the skills of professional designers of annual reports) to make sure the best and most effective one ever issued to
- those consisting almost entirely of financial statements prepared in the customary accounting style.

The latter used accounting terminology (not understood even by some in the accounting profession), often preceded by a few patronizing remarks by the company president to employees. Although bodies like NYSE and SEC had taken a greater interest in the reporting by corporations, arguably, much of that interest tended to be cosmetic. Claire (1945, p40) argued that annual reporting be designed to be

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472 Niswonger (1949, p32) wrote, 'It is doubtful whether some of the proposals which have been made, particularly those with regard to depreciation, would be acceptable to management during a period of falling prices. We should not lightly abandon principles which have been evolved after a long period of study, discussion, and experience. Until new concepts are developed which will safeguard the integrity of financial reporting the present body of standards should be adhered to.'

473 This article is sometimes cited as Claire (1979).
understood and read not just by those skilled in understanding the terminology of business, finance, and accounting. The report was for

- stockholders,
- employees,
- the general public, and
- financial analysts,

some of whom were not so skilled. Financial statements were designed to provide a balance in disclosure to all readers, even if financial analysts required access to other sources.

Others pointed out that arguments for new forms of statements (including of financial condition rather than the conventional balance sheet) were not new. One suggestion was to use the narrative form rather than the balanced form. It was argued that the former violated the 'principle' that specific liabilities, or classes of liabilities, as a rule were not claims against specific assets or classes of assets, especially for a company with long term debt. As well, new forms of liabilities might arise which were difficult to classify, even on a balanced form of statement. A definitely misleading view might result (King, 1948, p353-354).

Some would question the function of accounting. Bailey (1948, p11) argued that function now ranged from stewardship to actual stockholders to usefulness in decisions by stockholders. He argued both are required, as would Chambers a decade later in his works antecedent to CoCoA.

However, Stans (1949, p5) differed, finding the adoption of complex new tools developed to measure concepts like economic income to be premature. To him prerequisites were the development and use of

- a comprehensive code of AAP,
- standards of disclosure,
- better terminology,
- greater uniformity, and
- less latitude in present techniques.

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474 Bailey (1948, p11, emphasis added), 'If decisions affecting the future must be taken in light of the past, the income statement must be useful for the future or else we accountants are going through a lot of work that has no value except as mental gymnastics.

'Let us develop this point of usefulness for judging the future, because it is one point on which accountants have not always agreed. This disagreement has been shown by the controversy which has been going on about the “prospectus” type of income statement versus the “historical” type; also by the discussion going on about the all-inclusive income statement compared with the type of statement which excludes certain items which are believed to distort. The disagreement is back of the proposition that income statements are intended to be a report of stewardship. Of course the income statement must be historical! It can deal only with things that have happened. It cannot in itself forecast the future. But the presentation of historical corporate income, it seems to me, must meet the same tests, whether it is a report of stewardship to actual stockholders, or a report to prospective investors.'
Taggart (1949, p60) warned that general acceptance by management, the court, legislators and the general public was required if 'the perfect concepts and standards and the highest sense of social and moral accountability' were to be achieved.\(^{475}\)

While various tensions continued in accounting debate generally during this period, they also continued for issues of 'liability'.

### 5.2.3 Reporting of liabilities

Classifications found in the UK 1948 Companies Act included liabilities, provisions, revenue reserves, and capital reserves. Tensions followed on definitions and distinctions among terms (Edey, 1979, p228). In practice, little dissatisfaction was found (Hein, 1978, p234; Nobes & Parker, 1979, p200).

In USA, Dohr (1941, p203-204) used the term 'reserve' to illustrate difficulties faced by the lay person regarding accounting terminology. One of the five uses was one for a liability.\(^{476}\) Wellington (1947, p102) pointed out reserves were used to smooth reported earnings. Wertz (1941, p319) too questioned the terminology, pointing out that 'liability' had a customary meaning of being a debt or obligation due and payable at some determinable future date. However, in financial statements it was used to describe all items on the non-asset side of the balance-sheet.\(^{477}\)

In seeking definitions expressed in simple and popular language, Kelley (1941) used as an illustration one of a liability - bonds. May (1942) responded (and also commented on Whitney (1941) met earlier). May conceded that at first CAT too had sought such definitions. However, this task was extremely difficult, as simplicity was obtainable only at a sacrifice of accuracy. May found Kelley’s definition of liability simple, but inadequate to deal with items such as:

- advance royalties received for which no obligation to repay existed under any circumstances,
- reserves for possible losses on commitments,
- reserves for possible liabilities for alleged patent infringements,
- existing obligations to pay rents or interest in the future, and

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\(^{475}\) In a manner implicitly at odds with May's ideas, Taggart (p60) continued, 'Accountants cannot survive by wrapping the role of righteousness around themselves and retiring to the contemplation of the beauties of truth. Achieving acceptance of adequate accounting concepts and standards by those outside the profession is part of the accountant's job, too.'

\(^{476}\) Dohr explained, 'The term "reserve" is used to indicate (1) a certain type of asset (as in banking), (2) a deduction from an asset to bring it to an appropriate valuation, (3) a liability, (4) an item falling in the area between liabilities and proprietary capital, and (5) a sub-division of proprietary capital.'

\(^{477}\) Wertz continued, 'I doubt whether it contributes to understanding to characterize surplus, and particularly earned surplus, as a liability. If we have as our objective the presentation of the clearest financial statements we can devise, there seems little to recommend a more or less arbitrary definition of terms we want to use. If the practice of accountancy were a science only of direct concern to those initiated into its mysteries, little objection could be raised to such definitions. However, the widespread use of accounting reports demands that any reconsideration of terminology will result in making accounting statements perfectly transparent to all readers. We can, however, do something to render them less opaque by using terminology less ambiguous to the reader.'
The alternative adopted by CAT was to define liabilities in relation to accounting rules and principles as set out by CAP – the technical definition – which certainly caused tensions in application.478

May’s (p36) use of Kelley’s citation of the controversial case of the treatment of bond discount (recall 3.2.3) shows how the debates were in principle unresolvable. Kelley acknowledged it was commonly carried as an asset (in accordance with the committee’s definition of asset) but that it was not an asset in other definitions. May (p36) concluded, ‘On the other hand [Kelley’s] definition of liability bars the treatment of the item on that side of the balance-sheet .... It must be treated somewhere.’ The AAA Revision proposed its inclusion in the valuation of the related liability, but May was not in favour of that treatment – a debate unresolvable under conventional accounting.

In AAA 1941 Revision, the term ‘liability’ is used in several places, primarily in connection with the determination and treatment of any gain or loss on the discharge of the liability (p53-54, Paragraphs 5 & 6; p56, Paragraph 3). Some discussion of the determination of the cost of a liability is included and the method of presentation is briefly stated. The ‘bond discount’ debate would in part be resolved by fiat.479

The terms ‘indebtedness’ and ‘obligation’ are used (p54) as synonyms for ‘liability’. When discussing the gain or loss arising on the discharge of a liability, reference is made (p56) to ‘interest on borrowed money, adjusted for debt discount and premium.’ The relationship of these terms to liability is not made explicit. As in the 1936 Statement, reference (p56) is made to ‘earned surplus reserved for contingencies’, it being stated that this remains a part of capital. The term ‘creditor’ is used as well. One usage (p54) is in the sense of a party which supplies cash, thus constituting a liability. Other usages refer to creditors with ‘interests’ (p52) or with ‘rights’ (p53). No discussion of explicit interrelationships among usages is provided.

The Revision added little towards a definition of ‘liabilities’. The emphasis remained on an income determination process which was input-oriented with a matching of realized revenue and costs. Attention was directed towards the identification of those elements. Those included in a balance sheet – including liability – received relatively scant attention. This would be in part redressed by the next revision.

The term ‘liability’ is used throughout the AAA 1948 Revision. It is used in the definition of income (p14) - the increase in the net assets (assets less liabilities) of an

478 Bailey (1948) discussed various ARBs with a liability bent, including No23 (1945) re Income Taxes (p13), No26 (1946) re Use of Special War Reserves (p15), No28 (1947) re Contingency Reserves (p16) and No31 (1947b) re Inventory Reserves (p18). As well, ARB No30 discussed items to be classified as ‘current liabilities’.

479 AAA (1957, p54), ‘On a balance sheet the unaccrued portion of such interest should preferably appear as an offset to the maturity amount of the indebtedness. Conversely, the excess of the cash or cash equivalent supplied by the creditor over the maturity amount represents a liability payable from period to period as a part of nominal interest payments; on a balance sheet any unpaid portion of such liability should appear as an addition to the maturity amount of the indebtedness.’
enterprise. As is to be expected, the term is also used in the explanations of revenue and expense (p15). A definition of ‘liability’ is given (p16); it is one class of ‘equities’. Equities are recognised in terms of assets or services received or obligations incurred. The connection between ‘obligation’ and ‘liability’ is not explicitly stated, it remaining unclear whether the terms are synonyms or if one is a subdivision of the other.

The discussion of liabilities (p16) begins with the proposed definition,

Liabilities are claims of creditors against the enterprise, arising from past activities, that are to be satisfied by the disbursement or utilization of corporate resources.

The discussion continues with the measurement of liabilities,

They are measured by cash received, by the established price of noncash assets or services received, or by estimates of a definitive character when the amount owing cannot be measured more precisely.

No elaboration of what constitutes an ‘estimate of a definitive character’ is provided. However, a clear distinction is envisaged between the definition/recognition and the measurement of liabilities. This is reinforced by the claim that a liability may exist even though it cannot be measured in monetary terms, only estimated. The remainder of the discussion of liabilities is devoted to the treatment of any difference (premium or discount) in determining the amount of the related liability.

The term ‘liability’ is found in Financial Statements (p17-18, Standards 3, 5 and 14). The presentation of liabilities on the balance sheet is discussed, Standard 14 dealing with ‘reserves’ and raises the problem of the connection, if any, among ‘reserve’, ‘liability valuation account’ and ‘liability’.

In order to remove confusion associated with the use of the term ‘reserve’ in the published reports of corporations, it was concluded (p19)

1. The term “reserve” should not be employed in published financial statements of business corporations.

480 In the section entitled ‘Balance Sheet Classification’ (p20-21), one paragraph includes, ‘Some liabilities are subject to substantial uncertainty as to amount. Such liabilities should be classified with the other current or non-current obligations of the enterprise and captioned or footnoted to indicate that the amount is estimated; if feasible, disclosure should be made of the extent of possible variation.’

481 The paragraph continues, ‘The reader of a balance sheet has a right to expect that the liabilities section discloses all creditor claims which, in the judgment of the management, based on reasonably objective evidence, are an established burden on the resources of the enterprise... However, improbable and conjectural claims, the existence or validity of which is contingent, preferably are revealed by footnote. If displayed on the balance sheet, such appropriations should be classified with retained income.’

482 To examine this fully, resort is necessary to Supplementary Statement No. 1 (AAA, 1957, p19-22) entitled ‘Reserves and Retained Income’.
This would entail the reorganisation of the balance sheet and related elements, as it was concluded,

2. The "reserve section" in corporate balance sheets should be eliminated and its elements exhibited as deduction-from-asset, or liability, or retained income amounts.

This would require 'liability' to be clearly defined.

Illustrations are provided of items which are/are not liabilities. The use of in-principle type notions like 'such time as it becomes appropriate' arguably required guidelines. The connection between 'obligations' and 'liabilities' remains in need of an explicit statement.

Supplementary Statement No. 3, 'Current Assets and Current Liabilities' (p30), endorses the conclusions of ARB 30 of the CAP. Included therein are definitions of 'current liabilities' and 'working capital'. Supplementary Statement No 4, 'Accounting Principles and Taxable Income' (p31-34), mentions 'liabilities' in (p33) 'the denial of deductions for accruals for known liabilities of indefinite amount.' This has at best only indirect issues for financial statement purposes.

Supplementary Statement No. 7, 'Consolidated Financial Statements' (p42-45) and Supplementary Statement No. 8, 'Standards of Disclosure for Published Financial Reports' (p46-50) do not include 'liability'. Both however refer to 'equities' (p42 and p48 respectively). In addition, No.7 refers to 'funded debt' and 'bonds and other long-term debt' (p42 and p44 respectively), while No.8 refers to 'short- and long-term creditors' (p47). The reader is required to reconcile these terms at an application level with the definition of 'liability' at a higher level.

No.8 also illustrates an as-a-problem-arises approach in discussing the treatment of selected items, concluding (p46) 'information concerning transactions such as stock option, pension plan, and long-term lease agreements, the results of which have not been reflected in the accounts as of the statement date, should be disclosed if significant.' Instead of arguing that a particular item is a 'liability' (as defined) and therefore is to be included in the financial statements, the argument resorts to the notion of 'disclose if significant'.

The 1948 Revision and its associated Supplementary Statements reveal advancement in the search for a definition of 'liabilities'. However, the use of potentially vague notions and phrases as well as the lack of coherence among terms like 'liability',

483 AAA (1957, p20-21), 'Deposits, advances, and prepayments by customers (sometimes classified as "deferred revenues") are liabilities until such time as it becomes appropriate to recognize them as revenue; it follows that they should be displayed in the liabilities section of the balance sheet. Items sometimes classified as deferred revenues, such as unrealized gross profit on instalment sales, are not liabilities. When the obligations of the concern have been performed, and related costs are capable of reasonably objective measurement, revenue should not be deferred on published financial statements even though deferral is permissible for income tax purposes.'

484 That 'obligation' is a broader term might be inferred from discussion in the next section 'Appropriations of Retained Income' (p21) of the 'obligation' of management 'to inform the users of published statements as to the objectives to be accomplished through the reinvestment of earnings.'
'obligation’, ‘claim’ and ‘debt’ led to unresolved issues of inter-relationships. The statement (p20), ‘In accounting as elsewhere traditional terminology is not immutable’ had perhaps unforeseen consequences for the Committee. New financial instruments were also appearing which seemed to require these hybrids to be classified separately between the traditional “liability” and “capital stock and surplus” captions (Wixon, 1945, p143).

During this period, debate on bonds and reserves/contingencies also continued outside the context of the AAA Revisions, including that on

- the treatment of premiums on scheduled retirement of bonds (Castenholz, 1943, p72; Accounting Questions, 1946),
- what to include in the amount of ‘discount’ (Castenholz, 1943, p71-72), and
- whether the discount (or amount amortised) might be included in cost of an asset (Accounting Questions, 1944, p67).

A summary of the vague position of AAP in this area is provided by Stempf’s analysis (1942, p68) of the recommendations in the AAA statement and ARBs. Others commented on the sometimes strange applications found here in published financial reports (Clendenin, 1941).

Regarding contingencies, tensions continued from the input orientation of the profit calculation. Stempf (1941, p112) argued conservatism and foresight, both applied in business judgment, demanded reasonable provision for future costs.\textsuperscript{485} However, where to classify the related credits and the calculation of the monetary amount reported led to debate (Galanis, 1947, p373; Stans, 1948, p190-191).\textsuperscript{486}

Items shown in financial statements were queried (Cranstoun, 1942, p85; 1942a, p360-361; Blackie, 1947, p198). Variations in treatment (Brink, 1946, p524-525) and in terminology (Blough, 1947, p422; 1947a, p63; 1947b, p147; 1947c, p500) implicitly suggested a definition of liability is required to be able to classify the reserves.

Wellington (1947, p102) provided background information on ARB No28 (1947).\textsuperscript{487} It was a brief document as it was fraught with difficulties.\textsuperscript{488} ‘Separate problems’ (p113) included

\textsuperscript{485}These might be for planned maintenance or self-insurance. Stempf used the AAA 1941 Revision for a context and restated his argument in a later paper (Stempf, 1942, p69-71).

\textsuperscript{486}Galanis, (1947, p373), ‘Because balance-sheet reserves are set up in connection with a multitude of items such as possible inventory declines, taxes, deferred maintenance and repairs, pension funds, etc., it would be well for all such reserves to be detailed and identified in balance-sheet presentations. This would enable the analyst to figure out whether reserves set up represent reasonable estimates that may be drawn on later, or are merely arbitrary segregations of surplus aimed at reducing reported earnings and, in turn, serve as a prop to hold down dividend disbursements or for other purposes.’ There was no discussion of the underlying reasoning for presentation.

\textsuperscript{487}One school of thought argued that any problems resulting from a distortion were overcome by ‘adequate disclosure’ of entries affecting reserve accounts. However, Wellington (p102) claimed there to be a ‘growing opinion that disclosure itself is not sufficient if the result of the reserve entries is to seriously distort income.’ He preferred financial statements understood by the average reader rather than they being technical documents with ‘complete disclosure.’

164
reserves arising out of WW11 (ARB No13 and No26),
- those specifically covered in ARB No28,
- those for future consideration (like inventory reserves, reserves for specific but undisclosed contingencies), and
- the general use of the term ‘reserve’.

The profit determination emphasis meant the debate was unresolvable. The committee did strongly argue against any use of general purpose contingency reserves to smooth periodic income ‘by mere whim’. However, an Editorial (1947b, p183) added to the confusion surrounding contingencies by suggesting that one ‘useful purpose’ of surplus was as ‘a reserve for contingencies and bad times’, adding that if surplus was not retained for such a purpose, ‘an entire enterprise might be jeopardized, especially in all but very prosperous times, and that would adversely affect job opportunities.’ Taken literally, the argument meant almost all of the writings on reserves for contingencies were wastes of resources, as no need existed for separate accounts.

The reporting of leases (ARB No38, 1949) led to an application of reciprocity in the treatment of the asset in entity A and the liability in entity B (Sprague, Chapter 3). Issues dealing with assets and the related ‘off-balance sheet’ liabilities489 were considered (ARB No43, 1953, para3 and 5). The ability of conventional accounting to deal with the issues was questioned.

The issue would be recycled in research (Myers, 1962) sponsored by the practitioner wing of the profession.490 Problems faced in lessees’ financial statements491 and in those of lessors492 were analysed and discussed. Much emphasis was placed on the contract and its agreed premises, but little resulted conceptually on definition.

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488 ARB No28 (1947, p113), ‘Accounting for reserves and their presentation in financial statements involves problems that are both numerous and complex. Since complete solution of all the relevant problems has not been considered possible at an early date, the committee has deemed it wise to separate the problems for individual treatment.’

489 Again these are made topical by the Enron case (The Economist, 2006c, p57).

490 With the warning any discussion did not represent their official position.

491 Myers (1962, p1), ‘Of special interest are those cases in which the lease has been used primarily as a financing device. Probably one major reason for the growth of this use is that the lessee has felt it wise to take advantage of the traditional accounting treatment of a lease under which rental payments are recognized only at the scheduled payment date or by accrual between dates. By not showing the liabilities on his balance sheet, the lessee has conformed to a supposed standard of financial circles – the lower the liabilities on the balance sheet, the higher the quality of the company.’

492 Myers (1962, p63), ‘As is the case with accounting for lessees, the lessor seems to have but two basic methods of accounting for leased assets. The “rental” method records each receipt as rent on the use of an item carried as a fixed asset. The fixed asset is depreciated in the normal manner. Depreciation as a cost is matched against the rental revenue.

‘The second method is the “finance” method. On the date the lease becomes effective a receivable is set up, and the fixed asset is reduced. The difference is revenue. Problems in the “finance” method arise as to the size of the receivable to set up, the amount of reduction in the fixed asset account, and the timing of the recognition of revenue. Two problems which arise with the “rental” method are (a) the separate classification of assets out on lease or available for lease and other assets and (b) separation of rental revenue, and accompanying expenses, from sales revenue and the cost of goods sold.’
5.3 Australian experiences and Chambers’ early writings

A review of the history of accounting in Australia reveals that, being colonized by UK, Australia’s early economic and business activity was naturally closely intertwined with UK economic and business activity (Gibson, 1971; Zeff, 1973). Thus the influences on accounting traced in earlier Chapters may be applied here. Accounting drew on the legal system for rule making and the Australian legal system was based on that of the UK. For example the 1862 Companies Act had been adopted by the Australian colonies and the 1936 NSW Companies Act was based on the 1929 UK Companies Act (Gibson, 1971, p67-73; Evans, 1974, p 62; Walker, 1978, p107). Australian trade was mainly with the UK and many subsidiaries of UK companies operated in Australia, who naturally followed the reporting practices of their parent companies. The UK taxation system with its emphasis on the distinction between capital and income also influenced accounting practices.

A predominant accounting professional body, the Institute of Chartered Accountants in Australia (ICAA) had grown out of the ICAEW, being established in 1928. ICAA (1946) published its ‘Recommendations’ based on similar ones by the ICAEW. As Evans (1974, p64) comments, ICAA (p3) acknowledged reliance on the UK Recommendations (Zeff, 1973, p3-4; Parker, 1982, p427). As well, other bodies were formed (Poullaos, 1993).

Until the end of the 1940s accounting in Australia was very similar to that in the UK – an historical record of a particular stewardship. However, the profession in Australia took initiatives of its own at the Australian Congress on Accounting (1949) under the theme ‘A Revaluation of Accounting’. While Australia had not yet experienced a major fraud (like RMSP or McKesson & Robbins in UK and USA respectively), a point made by Fitzgerald (1949, p18), Birkett and Walker (1971, p 98) noted:

A number of accountants recognised that there was confusion both within and without the profession as to the standards which were to govern practice, and that it was incumbent upon the accounting profession to take steps to resolve the confusion.

493 Parker (1982, p426), ‘Australian company law was originally a fairly faithful copy of the British Acts of the 1850s and 1860s. It was not until the late 1890s that there was a serious divergence. The Victorian Companies Act of 1896, passed in the wake of the collapse of the land boom and the fall of “Marvellous Melbourne”, was the first within the British Empire to regulate the financial reporting of trading companies…. It was not popular with most businessmen, lawyers and accountants.’

494 It has been suggested that early recommendations of the ICAA (and ICAEW) were rather scarce because the bodies believed their role should be mainly confined to the administration of the Institute affairs (Zeff, 1973, p4).

495 As evidenced by ICAEW Recommendation (N.15) (1952), ‘... the primary purpose of the annual accounts of a business is to present information to the proprietors, showing how their funds have been utilised and the profits derived from such use. It has long been accepted in accounting practice that a balance sheet prepared for this purpose is an historical record and not a statement of current worth …’
The Congress addressed issues such as

- the mechanics of accounting,
- professionalism, and
- the theory of accounting.

It was suggested that a Committee supported by expert and adequate research staff be formed to develop accounting principles or standards. However, the Congress appeared to pre-empt radical research and developments by affirming that accounting was an historical record of stewardship. This (re)-affirmation appears in hindsight to have set the scene for the 1950s during which time little was achieved in this area.

Instead, institutional issues were considered. Various other professional bodies merged to form the Australian Society of Accountants (ASA), leaving it and the ICAA as the predominant organisations. Both bodies established part-time research committees. However, there was little formal research into accounting standards. The 'continued revision' of standards suggested at the Congress did not occur (Birkett and Walker, 1971, p103). Rather, these committees spent time on terminology and publishing Technical Bulletins (Zeff, 1973, p33-34). It was determined during this era, however, that the auditor did not certify the accounts but rather reported on their conformity with generally accepted accounting principles (GAAP) so as to give a true and fair view. Overall, little of great significance occurred during this era at the underlying reasoning level, particularly in relation to the development of accounting standards in Australia.

Chambers (1970a, p39) relates his early experiences when working in a government regulatory agency which required the analysis and comparison of the financial positions, results and the costs of business firms in different industries. He found conventional accounting deficient as the resulting financial statements made comparisons between firms, even in the same trade, most difficult. A great sense of uneasiness in dealing with something quite undisciplined and subject to no firm principles left him quite disenchanted about accounting.

A teaching of aspects of management followed, especially an interest in financial aspects of business. To Chambers, their study provided, in microcosm, examples of relationships among owners, managers, creditors, customers and competitors. He argued changes in attitudes and actions of any of these parties required changes in actions, tactics and strategies of the firm.

His writings in the late 1940s reflect his interests in education, research and problems faced in accounting at both the underlying reasoning and application levels. Those of interest to this study include matters like

496 See Fitzgerald (1949, p36); Forster (1949, p45); Chambers (1949b, p46).

497 In 1952, the NSW State Council of ICAA requested an Accounting Principles and Procedures Committee be established. This would be similar to that of the AIA in USA but it would not have the power to make pronouncements in its own right. The Executive Council did not act on the request (Zeff, 1973, p6).

498 Chambers (1970a, p39), 'The immediate post-war years provided numerous frequent and varied examples of the shuffling and bargaining and haggling which go by the general description of adaptation.' This is well illustrated in Chambers (1958, p404-405).
financial statements and their analysis (Chambers, 1948),
the function of accounting (Chambers, 1948a),
the difficulty for (conventional) accounting to deal with price level changes
and related problems which arose for management (Chambers, 1949), and
the discretion available under GAAP to management in financial statements
(Chambers, 1949a).

All were linked to issues topical then (and arguably still now) and Chambers would
continue to refine his ideas over following decades.

5.4 Summary and conclusions
Certainly by the 1950s, various factors pushed corporate capitalism into social realms.
Economic power was concentrated in large corporate units. These could meet modern
demand for high standards of living by providing mass production and distribution.
Technological advance made mass production on a greater scale possible but the
quantity and prices desired were accomplished by these large corporations.
Management there was to possess great powers in its own organization as well as in
industrial planning at the national and local levels (Berle, 1954, p164-165).

Argument
5.11 Growth occurred in people's capitalism via direct investment in shares of a
corporation and indirectly as creditors, employees or consumers.
5.12 Growth occurred in investment in shares via the expansion of pension and
superannuation funds.
5.13 Much discretion still remained for the application of 'judgment by management',
especially regarding 'publicity'.

Argument
5.21 The corporation in USA became a social construct as well as being previously
an economic one.
5.22 Data sought for CG and choice were not necessarily of a financial type.

Accounting remained beset with various tensions at both the underlying reasoning and
the application levels.

Argument
5.31 Was the stated recipient of a balance sheet a lay-person or a technical person?
5.32 Questions were raised in Australia in a 'Revaluation of Accounting' at both the
institutional and information levels.
5.33 Lacking underlying reasoning based on logical premises, problems in reporting
continued to be approached in a case-by-case manner.
5.34 Data of social and economic type seemed intermingled with that of a financial
type.
5.35 Questions were asked like 'What was “reasonably objective” evidence’?

Tensions in accounting in turn reflected on debates on the reporting of liabilities.
Arguably there had been improvement regarding the element 'liability'. Unresolved
issues still existed at the identification/ recognition level and the monetary amount
level. It has been shown that various controversies surrounding bond discount and
Premiums have been argued in the literature for several decades. These controversies have included both questions of principle (whether bond discount was interest, whether accounting reports should be isomorphic with economic conditions or be prepared under technical accounting assumptions) and questions of technique (the method of amortization to be used). As well, the reporting of contingencies continued to provide tensions for and problems in the inclusion in the accounting processes.

**Argument**

5.41 A clear distinction was suggested between identification/recognition and measurement of liabilities.

5.42 Treatment of selected items with interactions for liabilities, like pension plans and leases, produced tensions for reports under conventional accounting.

5.43 New financial instruments provided difficulties for classification as either liability or owners’ equity, leading to suggestions for a third element on the equity side of the balance sheet.

5.44 What was the connection, if any, among terms like ‘obligations’, ‘liabilities’, ‘claims’ and ‘debts’?

5.45 What was ‘an established burden’ and how might it be related to ‘reasonably objective evidence’?

5.46 How were ‘improbable and conjectural claims’ to be made operational?

The corporation was placed in an environment which in some ways had not changed from the old days of the joint stock company. However, in other ways great changes had occurred. The situation is summarized in Figure 5.2.

The corporation still provided a way to finance large investments while at the same time protecting investors. However, the investor group had expanded to include other groups like employees, consumers and the like. As well, groups like investor analysts took a keen interest in the financial information provided. Corporate governance and control were still sought by the publication of reports on the state of affairs. However, these reports, now under the control of the accounting profession (and its practitioner wing), were produced under conventional accounting. The output here was certainly questioned. As well, the reports mingled the time frame of that information. Not only was retrospective data reported but also contemporary and anticipatory data.

In the next chapter, analysis of the questionings continues as well as the identification of Chambers’ proposals to provide a theory – CoCoA - to provide a basis for the required ‘publicity’.
Figure 5.2

Shareholders  Financiers  Others

Protection of investors  Large scale investments

Joint stock companies
with limited liability

CONTROL/
CORPORATE GOVERNANCE

Publicity  Registration & other controls

Financial  Non-financial

State of affairs  Economic  Social

Position  Performance
Chapter 6 The Framework: Corporate Governance in the Twentieth Century – Developments in the 1950-1960s

William S. Cook, vice president and comptroller [of the Penn Central Company], wrote a note... marked “personal and confidential” on October 5, 1967. In the note, Cook requested that the salary of Charles S. Hill, manager of general accounting, be raised from $25,500 to $27,500. As justification, Cook said: “His imaginative accounting is adding millions of dollars annually to our reported income.”

Daughen & Binzen, 1971, p223-224

Despite my considerable respect for his earlier work, it was not until 1961 that I came to full realization that Chambers was an intellectual giant, who was in the process of transforming accounting from a technical set of arbitrary rules into a rigorous conceptual framework and measurement system.

Mathews, 1982, p177

6.1 Introduction

In previous chapters, it was argued that one monitor under CG was the publication of financial statements. However, their function and contents had become ‘a technical set of arbitrary rules’, as Mathews states above. Indeed, some argue their development was captured (Chatov, 1975; Walker, 1987; West 2003) by the accounting profession, especially the practitioner wing. Arguably, as suggested in 4.3.2, standard setters need to be aware of how the current ideas underlying today’s CFs came to pass. The analyses in Chapters 2 to 5 inclusive – especially the decomposition of monographs, statements and other works to date – shows how the various ideas on accounting in general and liabilities in particular were derived. One aspect to emerge is that the dilemmas facing today’s standard setters had been met decades earlier.

The original capture of the accounting standard setting process – what is referred to as the May Legacy in this study – had several consequences. One already met was a blurring of any distinction between financial and economic. To some they became synonyms. Another, to be met as this chapter unfolds, were attempts to include in corporate financial reporting in some way non-financial information. Both consequences would certainly broaden the function and contents of financial statements. In contrast, Chambers saw a need to be quite concise and distinctive, based on, as Mathews states in the above, ‘a rigorous conceptual framework and measurement system’. As well, Chambers had developed rigorous views on the function of accounting and its interface with economics, finance and management.

Obviously, tensions had developed about the information provided. As suggested in Chapter 1, the intermingling of issues of distinct types needs unravelling for particular Propositions regarding liabilities to be tested. This in turn would, it is argued here, prevent the recycling of, in particular, debates on liability matters which are, in principle, irresolvable.
It was during this period that Chambers (1956, p584) wrote of the idea of 'accounting' as a generic term and not the province of conventional or financial accounting, leading to ideas of distinct (though interrelated at higher levels of abstraction) types of data. A mixing of distinct areas of interest has led to problems in accounting reports at both the underlying reasoning/policy and the application levels. In this thesis, it is argued that a variety of debates result from given multiple (and sometimes conflicting) objectives at both levels. These species with distinct features may be classified as conventional accounting, differing from financial, a subset of economic which in turn is a subset of the social species.

In 6.2, the analysis continues of the function and content of 'reporting' as reflected in various questionings found in the 1950-1960s. USA, UK and Australian developments are discussed. In 6.3, the publication of Chambers' magnum opus in 1966 is introduced with its emphases on reporting past and contemporary events. As expected, debates and tensions resulted in academic circles and between the academic and practitioner wings.

These tensions were found over time and continue currently, especially between conventional and financial type accounting. They were further compounded by the introduction of economic and social issues within those conventional or financial type accountings. An analysis of these tensions is integrated within the argument (6.4). Interdisciplinary issues and their influence on reporting are highlighted (6.4.1). The idea of a 'chain of relationships' (Gell-Mann, 1994, p9) is used in the context of various stakeholders in CG to analyse the accountability concept, relationships among stakeholders and the related issue of stewardship (6.4.2). Ideas from quantum mechanics (Gell-Mann, p139) of 'quantum state' and the related 'momentum' are seen to be consistent with the reports required in an accounting which, it is argued, covers a set of interrelated reports. Debate continued in various areas, leading to

499 Chambers (1956, p584), 'The ... use of the unqualified term accounting ... may not be misleading to those who are preoccupied with business accounting. We have long been accustomed to the use of accounting in the limited sense of business accounting. But why? Accounting is a generic term; several species, each having distinctive features, are recognized even by the novice. Each of these species of accounting has its peculiar form because it serves its own specific purpose.'

500 These were applied to research carried out under the sponsorship of the Urban Water Research Association of Australia and the then Water Board Sydney-ILLawarra-Blue Mountains. This research was in a context of a seeking the effectiveness and efficiency of New South Wales State trading authorities. Selected papers are found in Hagan and Staunton (1989) and an application of these ideas is found in Bogeholz (1999).

501 As already pointed out in Chapter 1, in this study 'social' is a catch-all-other category. Other researchers may subdivide it further. For example, in the water industry, Bogeholz (1999) found 'ecological' a key category. Others would undoubtedly see 'environmental' as a distinct category (Frost, 1999). This would certainly be needed in research into issues at distinct (though related) levels of abstraction in policy related areas. For instance, Argy (1995, p18, emphasis added) writes, 'However, what ... others failed to foresee fully was that deregulation would increase enormously the role and influence of financial markets in social and economic policy; that this would impose a major constraint on the ability of governments to implement (through tax and transfer policies) the community's preferred set of social priorities, and that it would create a strong policy bias in favour of low inflation and "small government", with corresponding aversion to low unemployment and government spending on welfare, health, education, labour market programs for disadvantaged workers and social infrastructure.'
tensions between the practitioner and academic wings of the profession. Finally, (6.5) a summary and conclusions are provided.

6.2 The Questionings of the 1950-1960s
At the social and economic levels, some questioned the accuracy of presenting the then USA corporate system as one in which competition was to be found. Certainly the great collective enterprises (active in the form of large corporations) did not follow the tenets of limited private enterprise found in classical economics (Berle, 1954). There the individual entrepreneur was one of a large group of small producers. It was seen as misleading to present the vast operations of corporations as 'private' as they certainly had a social face as well. Application of the classical law of supply and demand would be questioned as the new economic system created a planned equation between supply and demand. The laws of the classical economists were being subsumed by a social pattern relevant to new community demands (Berle, 1954, 11-12).

That was not to suggest that the new order was not without tensions. Berle (1954, p52-58) suggested that with previous economic checks on corporate power no longer holding, other checks were emerging. Cary (1962, p408-409; 1963), then Chairman of the SEC, found fights still to be fought over disclosure — fights which he initially thought had been won some decades earlier. One was the force of public opinion, implicit in the system of oligopoly (as contrasted with either monopoly or conditions under socialism).

The force of public opinion required publicity. Corporate management had to report in order to retain the confidence of not only shareholders and financiers, but also customers, employees, suppliers and the sector of the public with whom it dealt. If corporate management based its continued tenure on the application of power rather than underlying reasoning, Berle, (1954, p60) argued disaster eventually followed.

Corporate management could choose either a broad or narrow view of stewardship. This is turn affected whether management served as the nuclei of its organization or ceded it to say government in the modern state. In USA, it was argued that private rather than governmental decisions were soundest for the community. Arguably, management of the largest corporations moved toward an acceptance of greater social

502 Berle’s evidence was provided from the practices found in the oil industry and the sugar industry.

503 Cary (1962, p408-409) writes, ‘To my mind, the theory of complete disclosure is the principle which should underlie both legal rules and ethical standards ... It is the disclosure principle upon which a rational evolution of a theory of control over management must be premised. When I came to the SEC a year ago, I thought initially that the philosophy of disclosure had been fully depleted. Increasingly, however, I am convinced that in a pluralistic society — where, as in a business enterprise, so many forces are operative — disclosure is the most realistic means of coping with the ever-present problem of conflicts of interest.’

504 Ramanathan (1976, p516), ‘The traditional view of corporate performance is idealized in the quest to maximize profits. It also is widely acclaimed that a firm’s only social responsibility in a free market system is to maximize its profits, for in so doing, it is presumed to maximize its contribution to society.’
responsible. Thus corporate management was surprised to find itself concerned with philosophy. The direction of the steps taken during the second half of the twentieth century would necessarily help determine, in the twenty-first, the framework of many communities (Berle, 1954, p172-173).

6.2.1 The USA scene and related developments
Over the years to 1959, the CAP published some fifty one ARBs and four ATBs (Accounting Research and Terminology Bulletins, 1961). Overall, the work of the CAP met with mixed reaction (Chatov, 1975, p187; p192-194). McMullen, (1951, p158) questioned the elimination from published statements of the term ‘reserve’ as recommended in ATB No 1. The underlying reasoning was that the value of the term as an incisive tool of thought and disclosure had been destroyed by its use in so many different senses. The profession could not standardize a definition which would be in permanent conflict with a well understood dictionary meaning. The dilemma persists to present times, as later argument will show. Bekaert, (1952, p60) went even further, arguing that the preparation of financial reports were to be guided by a language of simple, everyday terms.

Kelley (1948; 1951) continued to question conventional accounting and May’s various arguments.505 However, favourable reaction to the work of the CAP was built around its work being a sustained effort to develop AAP and narrow the scope for alternative practices. Some argued that the work was premature as theoretical foundations were lacking. Chatov (1975, p185-192), having discussed questions such as the anti-intellectualism and even hostility of practitioners towards the academic branch of the profession, the reluctance of the SEC to enforce its powers and the emphasis placed on what practitioners did, concluded that the work of the CAP was largely an exercise in the art of maintaining the status quo.

The third revision (AAA, 1957, p1-12) of the original 1936 AAA Statement was similar in form to that of its 1948 Revision. As is shown in Figure 6.1, a section devoted to ‘Underlying Concepts’ was introduced and there were slight changes in terminology. Supplementary Statements, five in all, were again issued.506

On the function of accounting, the 1957 Revision (p1) was a little more explicit than predecessor Statements, ‘The primary function of accounting is to accumulate and communicate information essential to an understanding of the activities of an enterprise...’ However, conflicting views on what activities were to be accounted for remained.

Kelley (1958) commented on general matters in the Revision. Hendriksen (1958) analysed it in the context of the liability for taxation, while Leonard (1958)

505 Kelley (1951, p289) remained rather critical of May’s staunch opposition to any uniformity in accounting. Chambers (1966, p252-253) of course argued that debate here was often at different levels, mixing principles (as part of any underlying principles) and rules (as part of any application).

commented on the terminology in general and of liability in particular and Vatter (1962, p662) discussed the stated definitions. Staubus (1977, p24) found the Revision somewhat disappointing.

The ASOBAT (AAA, 1966) monograph was seen as a continuation of the association's 'consistent record of activity in the development of accounting principles, standards, and accounting theory generally' (Preface). In support of this

Figure 6.1

<table>
<thead>
<tr>
<th>1936 Statement</th>
<th>1941 Revision</th>
<th>1957 Revision</th>
<th>1966 ASOBAT</th>
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<tbody>
<tr>
<td>Preliminary</td>
<td>Prefatory Note</td>
<td>Prefatory Note</td>
<td>Preface</td>
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<tr>
<td>The Basic Assumption</td>
<td>I Introduction</td>
<td>II Underlying Concepts</td>
<td>I Introduction</td>
</tr>
<tr>
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<td>Business Entity</td>
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<td>Realization</td>
<td></td>
</tr>
<tr>
<td>Costs and Values</td>
<td>A: Cost</td>
<td>III Assets</td>
<td>III Accounting</td>
</tr>
<tr>
<td></td>
<td>B: Revenue</td>
<td>Recognition</td>
<td>Information for</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Measurement</td>
<td>External Users</td>
</tr>
<tr>
<td>Measurement of Income</td>
<td>C: Income</td>
<td>IV Income Determination</td>
<td>IV Accounting</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Revenue</td>
<td>Information for</td>
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<td>Internal Users</td>
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<td>V Equities</td>
<td>V Extension of</td>
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<tr>
<td></td>
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<td>Accounting Theory</td>
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<td>Statements</td>
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507 Staubus (1977, p24) writes, 'the opportunity to draw up a set of standards based on decision usefulness seemed to present itself. The result was, however, disappointing. The introduction was weak and the sections on "Underlying Concepts," "Assets," "Income Determination," and "Equities" substantially ignored decision usefulness.'
claim, AAA pointed to the 1936 Statement and the three Revisions. However, the 1966 Statement was envisaged as being different from previous statements. Indeed, some were to see it to be so different that they would query whether it was a statement of accounting theory.

A function similar to that of the 1957 Revision was envisaged (p1). However, an additional idea was certainly introduced — that of what is now termed ‘decision-useful’ financial statements. The structure and content were also to change dramatically, as shown in Figure 6.1. The Statement discusses characteristics of accounting in a context of it being a means of communicating information to stated users. A communication process would require agreed upon terminology, including a definition of elements like ‘liability’.

Staubus (1977, p25) regarded this as the turning point in the official and sponsored literature when the AAA Committee adopted the decision-usefulness approach. Chambers (1998, p36), however, was disappointed by the lack of consideration of measurement.

In AAA 1957 Revision, the term ‘liability’ is found in the
- discussion of the underlying concepts of ‘enterprise continuity’ (p2) and ‘realization’ (p3),
- determination of ‘expired costs’ in the income determination process (p6),

508 AAA (1966, pv), ‘Believing that the “series” inaugurated with the 1936 Statement had served its purpose and that the time had come for the Association to undertake a new and different kind of effort...

509 Morrison (1966, p97) thought ‘it offers little in the way of basic accounting theory as a foundation for a body of sound accounting principles governing the treatment of accounting information. Thus in this respect I believe that an essential part of the statement of basic accounting theory which the committee was charged to prepare remains to be developed.’

510 ASOBAT (1966, p1), ‘The committee defines accounting as the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information.’

511 Staubus continues, ‘While it was not able to carry through as far as one might have hoped, the Committee’s contribution to popularizing both the decision-usefulness objective and the standards to be used as criteria for evaluating potential accounting information (especially relevance, verifiability, and freedom from bias) was immense. One can only speculate about the extent to which the substantial dissatisfaction with accounting practices in the late 1960s and early 1970s would have been avoided if ... (ASOBAT) had been produced in 1957 (as it apparently could have been). It does seem clear, however, that in the mid-1970s it is playing a big role in the deliberations of accounting policy-making bodies, such as the FASB and SEC. Every sponsored study of fundamental ideas in accounting since 1966 has emphasized the decision-usefulness objective, and several have developed substantial structures of ideas on this basis.’ Staubus’s optimism might be questioned as similar criticisms of prescribed accounting persist (Clarke et al, 2003).

512 Chambers (1998, p36), ‘This, surely, was a proper place to deal with the logical conditions of aggregation and relation — and measurement generally. But, like most other products of committees and boards in the U.S. and elsewhere, ASOBAT had little to say about accounting as measurement.... [If] accounting could be shown, by argument and illustration, to be an exercise in measurement, nonsensical, superfluous, mutually contradictory rules could be eliminated.’
• discussion of ‘equities’ (p7), and
• section on ‘standards of disclosure’ (p8).

However, a definition of ‘liability’ must be inferred from a study of the section ‘equities’ (p7).

One subdivision of ‘equities’ of a corporation is ‘liability’, which represent the interests or equities of creditors which in turn are claims against the entity arising from past activities or events which, in the usual case, require for their satisfaction the expenditure of corporate resources. However, further criteria are required regarding ‘claims’ if consensus on a definition is sought. Some such criteria may be inferred from phrases like ‘contract or intent of parties’ in the discharge of a liability. However, vagueness appears in the case where some corporate securities may exhibit characteristics of both creditor and stockholder interests. Here the statement advises the security be classified according to its ‘dominant characteristics’.

Exactly where the term ‘obligation’ fits is uncertain. It is used once in the equities section; but it is unclear whether it is to be regarded as a synonym for or a subdivision of equities. The remaining discussion of ‘liabilities’ is about their measurement. The initial measure is ‘the agreed cash consideration or its equivalent’. Further particular instances in which measurement may present problems are then considered.

Further doubts are raised as to the definition of liability by references found in the Expired Cost subsection and the Standards of Disclosure section. The former states that liabilities are established by ‘the issuance of product guarantees, notice of adverse court rulings, and similar events’ (p6). These are not reconciled with the ‘claims against the entity’ idea.

Financial statements are to disclose ‘information concerning transactions such as stock options, pension plans, and long-term lease agreements, the results of which have not been reflected in the accounts’ (p8). Little discussion is found on whether or not transactions like these create a ‘liability’, although it may be inferred that such items may well fit the ‘characteristics’ of a liability.

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513 The case here is of preference shares. The argument was accepted by Staubus (1958) but this and Staubus’ comments were criticized by Leonard (1958, p401-402). Vagueness here persists.

514 These include the treatment of a premium or discount on the face value of the liability (usually for bonds) and the conversion of a creditor interest into a stockholder interest when discharging a liability by the issue of stock.

515 For example, questions arise on when a product guarantee constitutes a claim against the entity. Further, even if consensus is reached on that question, opinions may vary on its measure.

516 This approach is reflected in the ‘Dissents to the 1957 revision’ (AAA, 1957, p10-11). Moonitz, for example, would include any ‘future tax obligation’ (p11) in the financial statements proper, though supporting reasoning is not stated here.
The supplementary statements to the 1957 Revision provide little guidance as regards the definition of liabilities. First, liabilities are discussed from the point of view of the identification of the entity of the accounting. Second, liability issues were discussed within the context of the matching process. This led to the inclusion of warranties, pensions and taxes. Questions of monetary amounts followed. Third, the connection between 'realization' and a 'change in an asset or a liability' was considered. In all these cases, particular liability type relationships are discussed without resort to an explicit definition of 'liability'. The scene is set for discussion in later Supplements.

In Supplementary Statement No. 1, the term 'liability' is used when considering the purchase of an asset (AAA, 1964a, p694). The term 'obligation' is used in a similar way (p695). In Supplementary Statement No. 2, the term 'liability' is used in the development of a concept of realization (AAA, 1964b, p708-709) by it being related to 'a change in an asset or liability'. However, 'equities' (p709) are used when reporting these changes. The Supplementary Statement on Realization discusses the reporting of changes in liabilities (AAA, 1965, p312-313). It states that deferred revenue, being unrealized, is a liability (p317). It also uses the term 'liability' when describing holding gains and losses (p318). Problems regarding unfilled obligations to customers are introduced, particularly as regards warranties and guarantees (p316-317).

The Supplementary Statement on the Entity Concept does not use the term 'liability' as such. Instead, it refers to 'creditors' and 'investors' as being parties interested in accounting reports (AAA, 1965a, p362) and examines the problem of accounting for leases (p363-364). No definite answers are provided. The term 'obligation' is used in this examination and the relationship between 'liability' and 'obligation' is not made clear.

517 The stated brief for the supplements reads, "The charge of this committee was to consider, and to advise ... what subjects should be reviewed and studied ... in the preparation of statements supplementary to ... 1957 Revision" (AAA, 1964, p425). Although a broader scope might seem possible, a narrower, more particular approach was adopted in principle.

518 Here (AAA, 1964, p425-426) one finds, "There are difficult and unanswered questions about ... guarantees of indebtedness for affiliated companies ... liabilities for purchase commitments to affiliated, but not controlled companies."

519 See (AAA, 1964, p426-427), "The ranks of estimated liabilities which have been recognized to accomplish a more precise matching have been swelled increasingly in recent years. One of the first of the expanded group was the estimated liability for warranties. Two controversial problems in current accounting (are) whether, and to what extent, to recognize currently the costs of pensions to be paid in the future; and whether and to what extent, to allocate income taxes between periods."

520 The section (AAA, 1964, p427-428) headed 'Questions for study' includes, "7. Provisions for guarantees, returns, allowances, losses in litigation, and taxes prior to assessment, should be related to realization if they determine revenue. How?"

521 Passing reference also appears in the section on objectivity (AAA, 1964, p431), "(a) Should precise measurements (purchases, payroll taxes, service contracts) be segregated from data that are less objectively determinable?"
explicit. The Supplementary Statement on the Matching Concept also does not use the term ‘liability’. However, the term ‘obligation’ is used with respect to the calculation of pension costs (p372) and the notion of deferred taxes (p373).

Possible reasons for the non-explicit, perhaps haphazard, treatment afforded liabilities are of course conjectural. Perhaps the committee members charged with the preparation of the supplementary statements were satisfied with the coverage of liabilities in the 1957 Revision proper; any matters regarding liabilities may not have been of a pressing nature. Perhaps there was so much preoccupation with matters like assets, costs, expenses and realization that there was little thought on liabilities.\textsuperscript{522}

An approach in which ‘liability’ is first defined as part of an underlying reasoning was still some time off. Yet reference to writings on liabilities in accounting shows continuing tensions.\textsuperscript{523} It is possible to argue that any abstract reasoning tended to be directed towards areas in which items are discussed as distinct problems requiring particular rules. What results is diversity and disagreement. Issues are easily seen as being simply recycled and debate without resolution. Certainly, criticism of the work of the CAP was increasing (Previts & Merino, 1998, p310-312).

On September 1, 1959, a new body, the Accounting Principles Board (APB) was created by the AICPA to assume responsibility for the tasks previously carried out by the CAP (Jennings, 1958). Changes in the business environment (including new forms of finance and changes in the taxation laws) and continued disenchantment with alternative AAP for the reporting of similar situations had led to the call for a new body. It appeared greater focus would be given to research.

At the same time, a Special Committee (1958) of the AICPA was established to consider guidelines for resulting research (Zeff, 1972, p167-173; Previts & Merino, 1998, p312-315). The findings included that various problem areas required attention at four levels:

\begin{itemize}
  \item postulates,
  \item principles,
  \item rules or other guides, and
  \item research.
\end{itemize}

The required different levels of abstraction were to see Accounting Research Studies (ARS) being issued as a basis for discussion and comment, the ARS then reviewed in light of submissions received and, based on the findings, a statement of AAP would be issued.\textsuperscript{524} However ARS1 (Moonitz, 1961)\textsuperscript{523} and ARS3 (Sprouse and Moonitz, 1965) were to contribute to the search for a theory to underline AAP, a possible inference being that May's conventional accounting did not resolve debates nor provide answers to problems.

\textsuperscript{522} Matters like accounting for leases and pension plans tended to be treated more from points of views like 'What is the asset?' and 'What is the expense to be matched against revenue?'

\textsuperscript{523} Two pioneering works were Moonitz (1960, p42), 'The diversity and variety of "liabilities" ... raise a real question as to the common thread or threads which hold them together....' and Trumbull (1963, p127), 'When to classify a given credit balance as a liability has recently become a question of greater interest.'

\textsuperscript{524} Moonitz, Sprouse, Grady (1965), Goldberg (1965), the Zlatkovich Committee (AAA, 1966) and others, were to contribute to the search for a theory to underline AAP, a possible inference being that May's conventional accounting did not resolve debates nor provide answers to problems.
1962) - both authors being from the academic wing - on postulates and principles respectively were considered too radical as they would lead to basic changes in current procedures and practices (AICPA Staff, 1963, 1963a; Zeff, 1972, p173-178).\footnote{180}

Gustafson (1970) later reviewed the contribution of ARS 1 & 3 in light of the work of the APB. He (p60) concluded that "in spite of a certain amount of harsh criticism, [they] have made valuable contributions to accounting thinking and several recommendations have been adopted by the accounting profession."\footnote{527}

The APB issued thirty-one Opinions and four Statements on various matters. Their contents had much in common with the work of the CAP. Both assets and liabilities were still defined in the context of the primacy of the income calculation based on a proper matching of revenue and expenses. Assets and liabilities continued to include deferred debits and deferred credits respectively, which were recognised and measured in conformity with GAAP.

An approach continued whereby GAAP, resulting from particular practices being questioned, were formulated in a haphazard manner. While this could be seen as being expedient, abuses continued and new questionable practices were introduced to meet particular situations which, in turn, given the lack of underlying reasoning to guide development, led to inconsistent answers and problems of excessive variations in reporting the affairs of companies (Kemp, 1970, p57).

Perceived problems arose from most members of the APB being partners of accounting firms who remained in practice during their tenure with the APB. The resources of those firms were called upon in researching and considering particular issues. To some inside and outside the profession, the \textit{independence} of the work and resulting findings was questionable - the process had been 'captured' (Chatov, 1975, p222-223; 226-230).

The APB too established GAAP from among the alternative practices which had been developed by corporate management in various industries. At that time, corporate management believed success was measured by interested parties by a \textit{stable growth}
pattern of earnings which resulted in increasing prices of their shares. It remained advantageous to have access to flexible GAAP.

The history of the APB and its demise are well covered by Zeff (1972, p178-268). Recycling of apparently unresolvable debates continued, perhaps quickening APB’s demise.

During this period, a monograph was prepared by a Study Group from the University of Illinois (1964). Dissatisfied with the state of accounting theory and the various attempts to formulate one, they sought ‘realism of conclusions’ and the use of ‘internal consistency and logic’. Arguably, the approach included resort to research methods involving processes of induction and deduction within a context of practice.

A consistent logical approach is not, however, necessarily in evidence from the treatment of ‘liability’ in the study. The term is used regularly throughout, the major discussion being found in the section (p17) on ‘Accounting Concepts’. Here, in a matter of some 300 words, one finds the terms ‘liability’, ‘equities’, claims and ‘obligations’ used rather indiscriminately.

The discussion commences with the statement that the term ‘liability’ is sometimes used as a synonym for ‘equities’ in accounting. It would appear that the study group itself uses ‘liability’ in this sense. The earliest reference (p5) is to ‘accounting for assets and liabilities’. One inference is that these are the key elements. However, when linked to the statement (p14) that ‘the total equities in an enterprise are always equal to its total assets’, it seems the equity of owners is a derived element. This is supported by the statement (p17) that ‘ownership equities differ from liabilities.’

However, problems of terminology arise from the statement that liability/equity includes all recognised ‘claims’ against the enterprise. ‘Claims’ may be a

- synonym for liability/equity,
- narrower subdivision, or
- broader class.

Terminological problems are compounded from inferences possible by the use of ‘recognised’ when linked to ‘claims’. While these problems are not explicitly covered, discussion continues on ‘equities’. It is argued that two principal classes of equities are ‘recognised’ in accounting:

- those which are residual in nature, and
- those which are obligations to be met in the ordinary course of business.

528 As implied by the stated purpose of the monograph, Study Group, (1964, Preface), ‘This study attempts to express and explain in concise terms the core of a general theory of accounting.’

529 Study Group (1964, Preface), ‘Throughout the study we continually related our conclusions to our knowledge of business and accounting practice. We were concerned with the realism of our conclusions as well as with their internal consistency and logic.’

530 See p5, 10, 12-13, 15, 17-18, 20-22, 26, and 28-30.
The reader becomes aware that perhaps the terms liability and equity may not be synonyms, reinforcing confusion as to the relationship of 'obligation' to 'equity' and thus to 'claim' and 'liability'.

Arguably, the term 'liability' is to be used to refer to the second class of 'equity' mentioned above. Whereas the first class, those residual in nature, do not legally require asset disbursement prior to termination of the enterprise, the second class must be satisfied by the disbursement of assets or the rendering of services. In the definition given of liability, it is stated:

*Liabilities* (i) are claims against an enterprise resulting from transactions whereby

(a) the enterprise receives goods and services, thus creating an obligation to pay for these goods and services;

(b) legally enforceable claims have been established;

(ii) must be measurable in monetary terms.

This rather confused state of affairs is summarised in Figure 6.2.

**Figure 6.2 Definition of 'Liabilities' in Accounting**

\[
L = E \text{ which includes all recognised C} \]

\[
\text{R} \quad \text{O}
\]

\[
= \text{perhaps?}
\]

\[
L
\]

\[
\text{O to pay for} \quad \text{C which are legally Enforceable}
\]

Where \( L \) = a usage of the term 'liability' rejected by implication

\( E = \) equities

\( C = \) claims

\( R = \) residual equities

\( O = \) obligations

\( L = \) preferred usage of liability.

The potential circularity in use of terms in the definition refutes any claim of logical consistency. 'Equities' are discussed in terms of 'claims' and subdivided into 'residual equities' and 'obligations'; 'obligations' are then termed 'liabilities' which are defined in terms of 'obligations to pay for' and 'legally enforceable claims'. The

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531 This is by implication only, however. Nowhere in the study is this stated explicitly.
use of qualifying words/phases/clauses (like ‘recognised’, ‘to pay for’ or ‘which are legally enforceable’) assume an element of importance here as they hint at different usages. However, if one seeks a definition of the term ‘liability’, then a tight, consistent usage of terms is required, not a vague and complex usage of the same, or similar, terms that seem to differ slightly.

The section on Accounting Concepts concludes with a discussion of selected items which are included or excluded from ‘liability’. First, it is stated that a contingent claim may require recognition for reporting purposes although it is not a liability as it is not measurable in monetary terms. Second, items to be included are the usual payables which are generally settled in cash and unearned revenues or deferred income which are generally settled by rendering services. Third, items excluded are the equities of owners when there is an absence of a requirement for these equities to be satisfied at a determinable future date. It would follow that such equities are liabilities if the date for their satisfaction is determined. Fourth, items which may be either included or excluded are deferred credits and special items. For deferred credits to be considered, investigation of the characteristics they exhibited is required. For special items where it is unclear whether they are liabilities or residual equities, resort is had to the dominant characteristics exhibited.

The study added to the vague, now more complex writings on liabilities. Underlying reasoning to structure debates was still needed. However, no definition of the concept was found in ASOBAT (AAA, 1966). Rather inferences must be made from the use of terms and related concepts like creditor or obligation as well as from particular cases or relationships.

The term most frequently used is ‘creditor’. It is primarily used in the sense of a party interested in information about an enterprise as they provide credit. That they have certain characteristics is acknowledged by the suggestion (AAA, 1966, p21-22) that those who ‘contract to buy major amounts of products or services over long periods of time’ assume the characteristics of a creditor-type relationship. These characteristics are not explicitly stated. In another usage (p57) the notion of ‘creditor claims’ is regarded as being ‘useful’ as a means of expressing goals if accounting is to serve in ‘the planning function’.

The term ‘obligation’ is used in two distinct senses. The first (p12) is to the obligation of the accountant to present information of a certain type. The second is found in Appendix A (p73) in the reference to ‘all resources, obligations, and equities found in an accounting entity.’ From this it may be inferred that three distinct classes of items are to be found in financial statements of an entity. However, in the sets of illustrative statements for the hypothetical XYZ Company in Appendix B (p82 & 84) the balance sheet has two groups – ‘assets’ and ‘equities’; the latter are subdivided into ‘total liabilities’ and ‘total stockholders’ equity’. ‘Lease obligations’ are listed among the subclasses of ‘total liabilities’. Figure 6.3 summarises the logically incompatible

532 Thus Preference Shares redeemable at a particular date would be a liability. However, unresolved issues here would continue to be raised decades later (Nair et al, 1990).

533 In a similar way, reference (p40-41) is made to ‘the accountant’s obligations to third parties or society in general’. ‘Responsibilities’ of accountants are discussed in the same section.
usages. It would seem to require a hierarchy of terms used in an interconnected manner.

A passing reference to 'obligation' is also found in the section on 'executory contracts'. One recommendation (p19) by the committee suggests 'greater recognition of executory contracts'. This apparently arises from the situation found in particular problems met in the reporting of liabilities. Such reasoning is consistent with a piecemeal approach to the formulation of an underlying reasoning. In support, it is argued, 'Many ... contracts meet the standards of verifiability, freedom from bias, and quantifiability at least as well as other reported events.' However, to identify the 'many contracts' to be reported, an explicit definition of liability is required so that whether those contracts meet the criteria and be included in the report may be tested. That some items do meet certain implicit criteria is seen from the items being shown as 'liabilities' on the illustrative balance sheets in Appendix B (p82 & 84).

Figure 6.3

<table>
<thead>
<tr>
<th>Items Found in an Accounting Entity</th>
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<tbody>
<tr>
<td>Resources</td>
</tr>
<tr>
<td>Equities</td>
</tr>
<tr>
<td>Obligations</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Items Found on a Balance Sheet of an Accounting Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>Assets</td>
</tr>
<tr>
<td>Equities</td>
</tr>
<tr>
<td>Total Liabilities</td>
</tr>
<tr>
<td>Total Stockholders' Equities</td>
</tr>
<tr>
<td>Lease Obligations</td>
</tr>
</tbody>
</table>

534 The recommendation (p33) reads, 'Therefore, the Committee recommends the reporting of all long-term leases, material and non-repetitive purchase commitments, pension plans, and executive compensation contracts including stock options or deferred payments and the like in dollar terms in the regular framework of the statements.'

535 See (p32), 'Present accounting also generally ignores, except in special circumstances, transactions involving an exchange of a promise for a promise. Leases, purchase commitments, executive and other labor contracts are generally denied recognition until the services or goods specified in the contract are either used, delivered, or paid for.'

536 This approach was questioned in the original 1936 Statement and Revisions.
A further reference is made to executory contracts when discussing the obtaining of current-cost data (p74). It is pointed out that ‘accrued gains on purely executory contracts – futures contracts – are recorded and reported’ in the inventory amount of entities in certain agricultural and mining industries. While these are issues of asset definition, recognition and measurement, related links to issues for liabilities arising from executory contracts are not discussed.

A recommendation is made (p19) that ‘relevant’ deferred income taxes should be recognized and reported in accounting statements. The discussion (p34-35) is rather inconclusive. The ‘relevance’ of deferred taxes to the users of external reports is stated, especially in a context of the prediction of cash flows. However, it is admitted that in some cases the relevance of deferred taxes is ‘less clear’, making it ‘a problem requiring further analysis.’ Both ‘Deferred Federal Income Taxes Payable’ and ‘Estimated Taxes on Increases to Current Cost’ are included as ‘liabilities’ in the illustrative balance sheets (p82 & 84). Brief discussion (p83) is given as ‘justification’, but, without a definition of ‘liability’, the link seems rather tenuous.

In ASOBAT, the first mention of the term ‘liability’ (p27) comes quite unexpectedly in the form of an example to support a standard of verifiability required of accounting data presented to external users. The term is not used again in the body of the statement proper. It may be inferred from particular items included in the illustrative balance sheets that ‘liabilities’ are a class of equities, but logical links among various terms like ‘equities’, ‘obligations’ and ‘liabilities’ are not made explicit. Other terms also appear in the statement – ‘debt’ (p24), ‘claims’ (p57) – as do references to specific items like ‘bonds’ and ‘mortgage notes’ (p75). Again their place in a hierarchy of terms is not made explicit.

ASOBAT does not effectively deal with issues of terminology in general or of liabilities in particular. This is rather intriguing given the awareness of the need for definitions.

APB Statement No. 4 (APB, 1970, p35-38) ‘was the first AICPA document to recognize [explicitly] the decision-usefulness objective. It also emphasized qualitative

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537 Hubbard (1966, p616), ‘Why is it that so many accountants’ studies have only tentative recommendations and conclude that further study is needed!’

538 See (p27), ‘For example, even statistically determined ... pension liabilities, and certain other liabilities, such as those for product guarantees, are estimates that typically have well below 100 per cent certainty.’

539 In Appendix A, the scope of discussion needed concerning the means of obtaining current-cost data about ‘a variety of short-term liabilities’ (p73) is raised. In Appendix B, the term appears in the illustrative balance sheets and supporting notes (p82 & 84).

540 Consider the following extracts: ‘... uniformity of meaning of words and numbers used in accounting is essential.’ (p13); ‘This uniformity refers to consistent classification and terminology ... and it requires precise meanings.’ (p17); ‘This consistency should relate to basic concepts reflected in accounting abstractions such as the nature of business income as well as to the terminology ... of reports.’ (p18); ‘Accounting is also concerned with effective transmission or communication of information. The committee believes the accounting communication method is in need of re-examination.’ (p64).
objectives' (Staubus, 1977, p23). The idea of ‘conventions’ to underlie accounting remained under challenge. Times were thought to be changing.\textsuperscript{541}

Ijiri (1971, p43), in his critique, pointed out GAAP were simply ‘customs’ or, as emphasised in this study, ‘conventions’. Since GAAP were seen as a basis for definitions in the Statement, he questioned the definitions therein. He (p46) suggested a control criterion was needed.\textsuperscript{542} He found the definitions, including that of liabilities, ambiguous.\textsuperscript{543}

As well, Ijiri (1971, p50, emphasis added) pointed out ‘any attempt to describe [GAAP] and their foundations is bound to be controversial because of the enormous complexity of current accounting practices and their economic, legal and social environment.’ If stakeholders other than accountants, in their decision-making processes have available financial reports prepared under conservative ‘best practice’ used by accountants, it is possible to question whether these other stakeholders were aware of the stated conventions.\textsuperscript{544} Any change from the use of conventions required a major shift among practitioners.\textsuperscript{545}

Some participants in various debates remained unconvinced by ‘academic’ theory. Of the influence of those in the academic wing to change the minds of the practitioner in

\textsuperscript{541}Staubus (1977, pxxi) summarizes the related events thus, ‘The twentieth century’s second wave of interest in securities markets, which may be dated from 1954 in the U.S., also created a demand for accounting information. In the early years of this boom, accounting appeared to serve reasonably well; at least, investors complained very little, perhaps because they were satisfied with the results of their investment activities. But in the 1960s problems arose, first in particular industries where it appeared that excessive optimism on the part of investors may have been related to misleading accounting practices. By the early 1970s dissatisfaction with the performance of the accounting profession became general, even including accountants themselves (and their insurance companies).’

\textsuperscript{542} This is linked to that of control in the corporate governance sense (Ijiri, 1971, p46): ‘The control function means that the resources [and obligations] of an enterprise are properly controlled by its managers and that their accountability to the owners is effectively established.’

\textsuperscript{543} Ijiri (1971, p48), ‘In general, the value of a definition lies in what is excluded from the concept. To be of any use, a definition must make clear what should not belong to the concept. The above definition does not indicate what items should never be considered [liabilities] in present or future [GAAP].’

\textsuperscript{544} Clarke \textit{et al} (1997, p242), suggest, ‘Under the Corporations Law, directors are required to possess knowledge of an entity’s current and expected solvency positions – an onerous task. However, it is one in which accounting has a major role to play. Recourse continuously to the market resale prices of assets (marking-to-market) would appear an imperative – albeit insufficient of itself – in meeting that legal obligation. Conventional accounting certainly does not produce information serviceable for those purposes, even on an annual basis.’

\textsuperscript{545} Chatov (1975, p11) concluded, ‘Accounting practitioners are highly sensitive about several subjects. For one, about their dependence on clients. For another, about their antagonism toward the SEC. For a third, about their ad hoc approach to the creation of generally accepted accounting principles. Fourth, about their dismal performance during the conglomerate merger movement. And fifth, about the potential conflict of interest between their auditing activities and their consulting services.... Caught between responsibility to clients and their needs on the one hand, and civil liability to third parties and government requirements on the other, the accounting practitioners are in a position where it is difficult to maintain and demonstrate independence. They have always been faced with the need to define their primary responsibility in the face of the impracticability of trying to adopt a middle course.’
the technical world, Staubus (1975, p163-164) was rather pessimistic.\(^{546}\) This view persists some thirty years on (Staubus, 2004). However, he (1977, p463) is not without hope of new younger academics becoming a 'new generation of intellectual giants.'

In APB4 (1970), basic elements of the financial position of an enterprise included liabilities. Their definition continued a technical application by relying on GAAP. It also extended the context from financial to economic.\(^{547}\) The definition was later seen to be circular, effectively defining nothing (FASAC, 2004b, p2).

APB4 did expand the AICPA position to incorporate various issues.\(^{548}\) The reporting of financial position was one where it had been expanded from a balance sheet to a balance sheet and notes. The 'notes' might include 'other matters', not necessarily of a financial type. Interestingly, the term 'economic' was included in definitions of basic elements.\(^{549}\) While not yet ready to abandon 'deferred' items, economic matters might now be included.

This was inconsistent with the Illinois group's (Study Group, 1964, p2-3) conclusion that a broad objective statement such as 'the measurement of economic events and the

\(^{546}\) Staubus (1975, p163-164) writes of the five broad AAA statements reviewed above: 'Have these statements had any impact on the practice of accounting? Have those preparing and auditing and using financial statements paid any attention? If you can answer these questions affirmatively, you have a more lively imagination than I have. Nor have the individual efforts of academic authors had much effect, with a few notable exceptions. I think Professor Paton, the elder, could be said to have had some influence which is detectable within his lifetime, but only because he has been blessed with good health. We all know that his Accounting Theory (Paton, 1922) was published in the early twenties and we also know that the constant interest rate method of amortization of premium and discount on bonds payable and the treatment of discount as a contra liability, both of which he recommended in 1922, were not considered the generally accepted methods until APB Opinion No, 21 in 1971. While that may give you youngsters cause for hope, it can also raise the question as to whether you can trust anyone over thirty to put much effort into the development of accounting thought. We may never see the payoff. In fact, I have often thought that publishing a book on accounting theory is a little like dropping a rose petal down the Grand Canyon and waiting for the echo. I don't recommend it if you are short on patience. While the pen may be mightier than the sword, I suspect that those who want to have some impact had better recognize that in union there is strength. For this reason, I recommend that you band together with your colleagues to respond to FASB and CASB exposure drafts. To date, the AAA as an organization has had about as much effect on the establishment of accounting principles as that little boy depicted in fountain statuary would have on a forest fire.'

\(^{547}\) APB Statement No 4 (1970, Footnote references omitted, emphasis added), 'Liabilities - economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Liabilities also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles.'

\(^{548}\) It stated (footnote references omitted), '133. The financial position of an enterprise at a particular time comprises its assets, liabilities, and owners' equity and the relationship among them, plus those contingencies, commitments, and other financial matters that pertain to the enterprise at that time and are required to be disclosed under generally accepted accounting principles. The financial position of an enterprise is presented in the balance sheet and in notes to the financial statements.'

\(^{549}\) For instance, '132... Liabilities - economic obligations of an enterprise that are recognized and measured in conformity with generally accepted accounting principles. Liabilities also include certain deferred credits that are not obligations but that are recognized and measured in conformity with generally accepted accounting principles.'
supplying of information for economic decision-making [was] of limited assistance in
an attempt to state the basic postulates and broad principles of accounting.' Instead,
emphasis was given to a broader version of stewardship as 'a more specific
identification of the primary purpose of accounting.'

That economic reports differ from financial ones was not a new tension. As argued in
4.3.2, expansion of the use of the balance sheet led to arguments on accounting like
those of Jardine (1931)\(^5\) that financial (and probably at that time conventional
accounting) position statements were quite distinct from an economic position
statement where resources were shown at their value-in-use (as opposed to value-in-
exchange).\(^6\) Interestingly, the former value, being an anticipatory calculation, would
not appear in CoCoA financial statements. Jardine's 'economic profit' would appear
in a related economic performance statement and would differ in principle from that
produced under conventional accounting or CoCoA.

Twenty years later, Dean (1951, p196) saw the need for distinct concepts.\(^7\) However, implications for liability definition and measurement remained vague.\(^8\) Hylton (1951, p503) added to the debate, seeing difficulties in definition and
measurement of economic income.\(^9\) Bell (1953, p53) obviously thought problems
could be overcome, but argued for the concepts to be seen as distinct.\(^10\) Discussion of
these themes continues in 6.4.

6.2.2 The UK scene
Writing in 1960, Yamey (1979, p238-9), while admitting some conventions
underlying accounting had stood the test of time, questioned the output of
conventional accounting given the changes which had occurred since the rise of
joint stock companies. These included,

\(^5\) Jardine (1931, p119) suggested, 'The attempted development of the balance-sheet as a measure of
wealth has been founded, it seems, on two fallacies:
(1) That it is possible to measure absolutely the use value of capital goods.
(2) That periodical net profit as determined by accounting methods is or should be coincident with true
economic profit.'

\(^6\) These distinct monetary amounts and their uses are often debated. Hills (2004, p46) questioned an
inability 'to explain the huge discrepancy between the valuation and the price someone was actually
prepared to pay for the property.' The former is value-in-use, the latter value-in-exchange. The matter
is further considered in FASB (2004, 2005). Some seem concerned that the distinction between 'fair
value' and 'exchange price' is not well understood.

\(^7\) Dean (1951, p196 emphasis added), 'The basic weakness of accounting reports for economic
analysis is that accounting is, as its name implies, an historical record, whereas economic problems
of management have to do with the future. As a result, economic ideas of income, assets and net worth
are not measured by the conventional financial reports.'

\(^8\) Hylton (1951, p503), 'When one begins to consider "economic" income, he immediately encounters
a baffling problem, and that problem is, just what is economic income, and how is one to measure it?
... [W]e are unable to find a widely accepted and useful definition of the term.'

\(^9\) Bell (1953, p53), 'Both the accountant's and the economist's measure of value and income are
needed and both together will serve more needs and serve them better than either alone.'
• the use of secret reserves with their posited claim of promoting the interests of long-term investors,
• the desirability of promoting the interests of long-term investors at the expense of shorter-term investors,
• the interest in company securities of a larger proportion of the population – either directly or indirectly,
• the fairly rapid changes in purchasing power of monetary units,
• the frequently controversial take-over bids, and
• the interest of those concerned with economic policy matters in financial statements of companies.

He hoped ‘that the Jenkins Committee [would] find it possible to include these aspects of company affairs within the scope of their arduous deliberations.’

The times during which the 1962 Jenkins Company Law Amendment Committee met were ones where much questioning was made of the various accounting reports. Certainly there appeared an increase in information available, but questions continued as to whether quality information was produced or whether conventional accounting could incorporate price level changes (Aranya, 1979, p269-270).

Consideration was given to the need of current valuations of assets to

• formulate dividends policies (Jenkins Report, para335-350)
• investigate efficiency of the required reporting (Jenkins Report, para12-13)
• evaluate take-over bids (Jenkins Report, para16).

However, after submissions from management and advice from the accounting profession regarding the function of the balance sheet being not to show the worth of items, conventional accounting and the related historical cost requirement were retained (Jenkins Report, para333).


Until the 1960s, the processes of reform of external reporting (especially following a period of crisis) in UK (and Australia) continued via an expert committee-change in company law approach. Aranya (1979, p271) documents selected developments in UK financial reporting. At first dominated by management (the suppliers), shareholders and creditors (the consumers) were ultimately to influence that reporting. These groups were supported by government as regulator/governor and a consumer in its own right.

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556 Extracts from the Jenkins Report are reproduced in Edwards (1980a, p213-409).
However, contiguously, the admission of the UK into the European Community and the subsequent amendment of the Companies Act (as required by the Fourth Directive) saw an Australian approach more independent of UK influence (Parker, 1982, p427).

6.2.3 The Australian scene
During the 1950s and 1960s, a distinct USA influence grew as Australia engaged in relatively more business and financial activity with the USA (Parker, 1982, p427). In the late 1950s the ASA, of which Chambers became a prominent member (and ultimately its National President), tried to promote ‘modern’ research. The ASA tended to look to USA while ICAA maintained its traditional UK links for guidance.\(^{557}\)

The profession, despite the 1949 Congress (met in 5.3), lacked a conceptually sound basis upon which to base accounting principles and related rules. It produced recommendations of best practice and supported specific corporate legislative requirements couched within the ‘true and fair’ qualitative standard.

Failures, including Sydney Guarantee Ltd (March 1961), Latec Investments Ltd (August 1962), Reid Murray Acceptance Ltd (November 1962) left investors bewildered (Clarke, Dean & Oliver, 1997, 2003; Sykes, 1988). Prospectuses, annual reports and auditors’ reports had suggested sound financial performance and status of companies. The companies had then failed, apparently without any or minimal warning.\(^{558}\) There were large unexpected write downs of real estate, inventories and debtors. The profession was roundly criticised by investors, the financial press, stockbrokers, analysts and appointed inspectors.\(^{559}\)

Initially, there was very little response from the profession. Some reiterated the argument of accounting reports being ‘technical documents’ (Birkett and Walker, 1971, p 109). Blame was placed on,

- poor financial management,

\(^{557}\) Birkett and Walker (1971, p135) observe ‘by the early 1960s the research ventures of both the Society and the Institute had virtually petered out, especially regarding research into standards’. The accounting profession continued to rely on legislation as a means of rule setting and the 1961 Uniform Companies Act (based on the 1948 UK Companies Act) accommodated that reliance to some extent.

\(^{558}\) Birkett and Walker (1971, p131) note, ‘Many of the failures followed hard on the heels of the publication of audited financial statements depicting a profitable past and an apparently sound present ... many of the failed companies had been in a state of crisis for some considerable period prior to their ultimate collapse. Their financial statements had not only failed to inform investors – they had also been misleading. These financial statements had been prepared by accountants, signed by auditors. In the public’s eye they were the responsibility of the accounting profession.’

\(^{559}\) Henderson (1993, p5), ‘In the late 1960s and early 1970s, there were a series of large company failures which were not predicable from a cursory glance at preceding financial reports. These corporate crashes led to significant losses and to wide-spread criticism of financial accounting. The critics argued that an accounting system which did not allow prediction of imminent failure was deficient and that these shortcomings of accounting contributed to the magnitude of the losses. Although some of these criticisms were directed at accountants as individuals the majority were concerned with accounting as a system. The perceived deficiencies were with accounting rather than with accountants.’
• defaults by credit customers,
• company law inadequacies,
• non-adherence to GAAP,
• misunderstanding of the legal significance of corporate groups, and
• defaults by some errant members (ASA, 1966, p5-6; Burgess, 1966, p542; Henderson, 1993, p5-6).

Broad issues of principle were generally avoided (ASA, 1966, p6; Kenley, 1965, p634), though some time later an investigation did follow on the feasibility of conventional accounting being replaced by other possible systems (Henderson, 1993, p6).

It was debated whether an SEC-type institutional change was needed (Urquhart, 1963; Chambers 1963b). Burgess (1966, p543) suggested the solution was in part the May answer of the 1920s regarding character qualities. Branford (1966, p545-547) sought positive action, but warned it would be a lengthy process to formulate and promulgate accounting principles, especially if the test was ‘generally accepted’. Rogers (1966, p547) saw a need for institutional changes of both infrastructure and professional types.

As well, debate continued on the form to be used in financial statements (Schumer, 1964, p488; Stewart, 1964; Pile 1964; Parker & Alien, 1986, p51). Jarett (1981, p53) would later provide illustrations of how new technology might incorporate both monetary amounts and related financial indicators (like earnings per share). Others discussed the quality of information provided, but it tended to be of institutional issues and of professional issues; any discussion of information issues were often within the context of GAAP built around conventional accounting (Gutteridge, 1965). The function of the balance sheet continued to be debated.

Bottrill (1967, p419) was most critical of the then present thought and practices, including

- an emphasis on the technique of ‘balancing’,
- little thought on the function,
- disagreements among accountants, and
- potential misleading of others users.

Clearly, recycling was recurring.

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560 Rogers (1966, p547), ‘It seems to me that to solve this ... situation there ought to be some tribunal to which any such dispute could be quickly referred and before whom the government body could be presented ...’

561 Bottrill (1967, p419), ‘To pose this question [of what is a balance sheet] to an accountant is almost as fundamental as asking him how he breathes. We still can remember with great satisfaction the first balance sheet we produced and the great delight it gave us when we were able to check that both sides of the balance sheet were in balance. I have a horrible feeling that there are many accountants who still feel that this is the most important thing about a balance sheet.

‘Accountants during their working life prepare many balance sheets but do you realise that we have no clear understanding or agreement as to what it is we are preparing. If this is the situation within the profession, you can imagine the misleading position we have created in the minds of those who depend on us for guidance.’
In the mid-1960s, the profession acted to implement a suggestion made at the 1949 Congress – to establish the Accountancy Research Foundation (ARF) jointly sponsored by the ASA and the ICAA. It was established to act as the research arm of the accounting profession (Zeff, 1973, p43). Ironically, a major sponsor was Stanley Korman of Stanhill and Sydney Guarantee fame (Sykes, 1988, p325-358). Arguably, it might be seen as another instance of ‘capture’ of the process.

ARF (1968, p385) sponsored a study on ‘four important questions of concern to our profession’. These dealt with

- objectives,
- whether financial statements were effective in meeting those objectives,
- limitations and shortcomings of those statements, and
- potential actions to overcome those limitations.

The ninety respondents are listed in Figure 6.4. Chambers was one of the professors from Australian universities who made a submission which criticised the questionnaire (Chambers, 1967d).

**Figure 6.4**

<table>
<thead>
<tr>
<th>Category</th>
<th>Respondents</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditors and accountants in practice</td>
<td>38</td>
</tr>
<tr>
<td>Chairpersons, directors or managers</td>
<td>17</td>
</tr>
<tr>
<td>Secretaries or accountants of public companies</td>
<td>19</td>
</tr>
<tr>
<td>Professors of commerce of accountancy</td>
<td>6</td>
</tr>
<tr>
<td>Officers of finance, trust and assurance companies</td>
<td>5</td>
</tr>
<tr>
<td>Chairpersons of stock exchanges</td>
<td>3</td>
</tr>
<tr>
<td>Bankers</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>90</strong></td>
</tr>
</tbody>
</table>

The discussion of ‘objectives’ (p386) included consensus that reports needed were of position and performance, but debate on users to whom the reports were directed. Chambers’ ‘continuously contemporary information on financial position’ was used. However, debate continued on ‘purpose’ (p386-388), ranging from compliance with Company Law to decision-making by those in various groups. As well, the ability to comprehend by particular stakeholders and issues of efficiency were raised but no resolution achieved.

Lengthy discussion of shortcomings and limitations followed (p388-394). Issues met in earlier chapters (like emphasis on form and presentation, non-disclosure of information, existence of permitted inconsistent GAAP and valuation rules) continued to be recycled. Actions to improve the state of affairs (p395-396) varied, dealing with both general and particular problems. Some suggested supplementary statements, especially to account for price level changes. Sounding suspiciously like a recommendation from Chambers, thought was given to developing ‘a carefully reasoned and substantiated set of ideas’ to supplant in education ideas commonly taught, and provide the basis for legislative action. Such radical proposals were not, however, accepted.
Chambers (1970b) would use the same title in an address. He argued problems arose from the input orientation of conventional accounting, \textsuperscript{562} terminological confusion, \textsuperscript{563} contradictions, \textsuperscript{564} inconsistencies \textsuperscript{565} and information to excess. His solution is CoCoA, once it has been placed within the total scene of decision-making.

However, tension developed from potential dominance by the practitioner wing. Chambers from the academic wing had much to offer in general terms as well as CoCoA in particular. Of the academic-practitioner tension, he saw distinct roles for the practitioner and the researcher. \textsuperscript{566}

As argued by Branford above, resort to criteria like ‘generally accepted’ \textsuperscript{567} for principles and related standards continued to be questioned. \textsuperscript{568} While Chambers argued that practice and research were to complement each other, reactions to financial collapses seemed to change little from attitudes met in earlier chapters. \textsuperscript{569}

\textsuperscript{562} Chambers (1970b, p20), ‘Accounting as it is now done and the financial statements as they are now published do not meet ... elementary commonsense tests. The primary concern of accountants is what goes in.’

\textsuperscript{563} Included here are the so-called ‘liabilities’ for deferred taxation payable and leases with the capitalization of obligations and rights. Chambers (p22) points out, ‘We are not denying that capitalization or present value calculations are necessary in deciding whether to lease or not.’

\textsuperscript{564} Included here one finds (p23), ‘Footnote explanations have been with us for some years. Some modern reports are, indeed, getting to look like the work of footnote-crazy pedants. The function of a footnote or “note to the accounts” is to explain, not to contradict or to confuse. This likewise is the function of notes in parenthesis.

\textsuperscript{565} These are the mixture of factual and non-factual data and the addition of past, present and future magnitudes. Included here is the use of ways to incorporate expected future contingencies in financial statements.

\textsuperscript{566} Chambers (1972b, p156), ‘In most fields, research is regarded as a specialized business in its own right. The business of practitioners is considered to be the solving of specific problems of clients. The business of researchers is considered to be the solving of general problems so that a useful general framework is available to practitioners in their dealings with clients. Practitioners may quite properly respect principles which are generally accepted among themselves. It is the function of researchers to question the substance of those principles and practices. ... One cannot be a “true believer” and a critic at the same time. Attitudes, knowledge and technique differentiate between the one and the other.’

\textsuperscript{567} Chambers (1972b, p156) summarises the argument, ‘Consensus of practitioners is no guarantee that what they agree upon is valid or useful, in principle or practice. The constant iteration of the phrase “generally accepted accounting principles” has clearly not stilled the doubts and anxieties of professionals. Researchers may not properly consider consensus or general acceptance in practice as any evidence of the validity of fruitfulness of any principle. The two different problems contexts of practitioners and researchers entail that each class has or should have a “mental set” appropriate to its own function.

\textsuperscript{568} Chambers, (1966, p248) stated, ‘Rules which are not consistent with the nature of things can be formulated, and they can be imposed on others and enforced among the group which sponsors them if the sponsor group is able to surround its operations with an effective mystique. But however consistently such rules are applied they are not the better for this kind of consistency.’

\textsuperscript{569} Evans (1974, p71), ‘... the dominant approaches to rule construction were still largely the same; reaction to prior abuses and codification of established beliefs as to best practice’.
An input oriented process still held sway in the late 1960s. The position statement still took the form of a balance sheet under the original narrow stewardship role. Tension between the two wings continued. The ARF remained relatively inactive until the early 1970s. A cynic might argue that its formation was a token acknowledgment by the profession that fundamental research was needed as a result of the embarrassing exposures of the 1960s. Arguably, it was the first indication that the Australian profession was to follow the lead already provided in the USA in establishing its APB - which, as argued earlier, did not resolve issues or debates.

In Australia, the practitioner-led approach of the USA was clearly followed by some. Kenley (1970) was based on Accounting Research Study No 7 by Grady (1965). A later publication by Kenley and Staubus (1972) was essentially in accord with the Trueblood Report (1973). However, that is not to suggest that Australian developments ignored UK initiatives.

In 1973, under the umbrella of the jointly sponsored AARF, the Australian Accounting Standards Committee (AASC) was given responsibility for the preparation of accounting standards. The issuing of Statements on Accounting Standards began in late 1973. It was intended that these would replace the Statements on Accounting Practice commenced in 1970, which had in turn replaced the earlier series of Statements on Accounting Principles and Recommendations on Accounting Practice (Evans, 1974, p 70).

AASC was criticised during the 1970s on a number of grounds. First, as in other Anglo-American countries' standard setting bodies, it was dominated by the profession (particularly by partners of the large public accounting firms, a criticism made of the APB in the Wheat Report, 1972) and therefore its membership was perceived as not representative of all interested parties (Henderson and Peirson, 1988, p 157). Second, its output was too slow. Only thirteen standards had been issued by 1978. Its explanation was that it was a part-time committee with very little support staff. Third, the standards continued to concentrate on particular problems and lacked an overall CF within which standards were formulated.

Developments, especially under the CF project in Australia, are returned to in Chapter 7.

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570 ICAA (1968, p 6), '... a balance sheet is not a statement of the net worth of the undertaking and this is normally so even where there has been a revaluation of assets and the balance sheet amounts are based on the revaluation instead of on cost.'

571 This shift in influence from the UK to USA was noted by Evans (1974, p 71), '... despite the general similarity between developments at this time in each country, as with Australian legal authorities, Australian professional accounting bodies definitely took a different line than their UK counterparts. The pre-1970 statements on accounting practice seemed to be the last rules substantially duplicating UK efforts.'

572 For example the work of the Jenkins Committee led Hein, 1978 (p 234-235) to note, 'Comparatively little dissatisfaction with the requirements for the presentation of liabilities on the balance sheet has been revealed by the current testimony of the witnesses before the Jenkins Committee. One relatively minor point may be worth noting.... The present trend of the practice in England is to show future tax as an item separate from either reserves or liabilities. Some witnesses favor changing the law to permit such treatment.' Other UK issues of the time are listed in Nobes & Parker (1979, p 202-205).
6.3 Chambers' 1966 *Accounting, Evaluation and Economic Behavior.*

Berle (1954, p13) drew what he called 'an interesting paradox'. The first half of the twentieth century was a period fertile and bold in physical science. Yet to him it lacked any correspondingly great hypotheses in economics or politics. Physical science went from experimentation to practical application, changing the face of the world. In economics, the measurements and tools, upon which scientific theories may later be constructed, were only being accumulated. In politics, he suggested emphasis was placed mainly on intuition. An exception was the use of theoretical ideas proposed by economists and philosophers. Without little doubt, one illustration of such an exception was the development of Chambers' CoCoA.573

Chambers' research and writings were influenced by his work experiences574 in the 1940s (1970a, p39) in various ways, including:

573 Dust-cover flaps of the text (1966a) provide an Abstract, 'Founded on the concept that the system of monetary signs is a prime language in any industrial society, this unique study provides a highly literate and comprehensively developed basis for the establishment of accounting as a principal source of financial relationships and economic actions.

'Treating accounting as a system of discovery subject to rules which govern like avenues of rigorous inquiry, this book finds the foundations of theory and practice in a variety of scientific disciplines - economic, psychology, law, metrology, communication theory. Accounting is shown to be a potential source of much more reliable information than is currently produced. The relationship of such information to the choices of managers, investors, and financiers is thoroughly developed. This book demonstrates the services of accounting as an information and communication medium, as a highly scientific measurement or instrumentation system, and as a branch of economic epistemology. Its conclusions bear on the study of the economics of the firm, organizational behavior, business finance, and related fields.

'Accounting, Evaluation and Economic Behavior provides a fully-rounded introduction to the field of accounting theory, giving a novel and systematic basis for its study and teaching. At the same time, being based on observed realities, its conclusions suggest concrete directions in which many aspects of accounting practice might move, for the ultimate improvement of the services given to client firms, to management and to the investing public.

'Indicative of the line of development of this study is the reinstatement of the balance sheet, and emphasis on the necessity of contemporary information in the balance sheet and income statement, and both in financial and cost or management accounting.

'In all, this work offers an ideal system for the accounting field, and a highly enlightening discussion of the major influences which have resulted in the deviation of traditional accounting practices from this ideal. With respect to its scope and its encyclopedic store of ideas, this important book is unparalleled in the literature of the field.'

574 Chambers (1970a, p39), 'Some twenty-five years ago I was engaged in a government regulatory agency which, for its purposes, required the analysis and comparison of the financial positions, results and the costs of business firms in all kinds of industries. For a time this work was my sole preoccupation. The conventional accounting processes on which the financial statements were based made comparisons between firms, even in the same trade, most difficult. The pressing tasks of administration prevented us from seeking a solution which would treat firms of different ages and sizes equitably. But the experience left a great sense of uneasiness, a sense of dealing with something quite undisciplined, subject to no firm principles. When I left that position I was quite disenchanted about accounting....

'For the following nine years I was engaged in the teaching of aspects of management. My main interest was in financial aspects of business; but as these aspects of business touch every participant in the activities of a firm in some way, their study I considered to provide, in microcosm, examples of the whole of the relations between a business entity and its owners, managers, creditors, customers, competitors, and so on. Changes in the attitudes and actions of any of these parties would require changes in the actions, tactics and strategies of the firm. The immediate post-war years provided
• analysis and comparisons using data from conventional accounting were most difficult, if not impossible,
• accounting seemed undisciplined and lacked firm principles,
• relations among stakeholders in a business entity provided a holistic view of that entity,
• changes in attitudes of any party would require changes in actions and strategies of the entity, and
• identification of the notion of adaptation.


From the 1950s, Chambers was involved in debates related to the function of accounting reports, generally in a context of CG but also within his ‘total scene’ of decision-making. He (1972b, p155) found it strange that although much time, effort and other resources had been expended on the development of AAP, problems continued, including the method by which they were developed and promulgated. His theme here would set the scene for later debates (Chambers, 1976b).

One had to do with the notion of adaptation. This was an anathema to two groups. The first was the followers of conventional accounting (and the May legacy) who employed the convention of ‘going-concern’, sought maintenance of the status quo and maintained control by the practitioner wing of the profession (recall Chapter 4). The second was the supporters of CCA who sought maintenance of material or physical wealth and control by a management group of the activities of the business entity.

As mentioned earlier, over the years various writers (for example, Canning, 1929; MacNeal, 1939) took exception to the output of conventional accounting, as did Chambers. Chambers’ (1966, p252) criticism of the balance sheet under numerous frequent and varied examples of the shuffling and bargaining and haggling which go by the general description of adaptation.'

575 Chambers (1972b, p155), ‘The American Institute has been in the business of making recommendations and pronouncements since about 1917, and the American Accounting Association has been publishing statements on accounting principles since 1935. It seems strange indeed that after all that time the question is still being asked: How should accounting principles be established? And strange that it should be asked by the two organizations which have already devoted more time and effort to the discussion of principles than perhaps any other professional accounting organization in the world. These motions seem to suggest that both organizations have grave doubts about the efficacy of all the “research” recommendations, statements, opinions and prohibitions they have sponsored or uttered at least in the last decade.’

576 Chambers (1978, p143), ‘But there is no rule of business administration or economic behaviour which entails that a physical capacity or a stock of material goods should be maintained. The adaptive behaviour characterized by the description “economically rational behaviour” entails that firms will seek the most promising deployment of the money (general purchasing power) that comes under their control day by day. In the face of shifts in demand and technology, it would be folly to insist routinely on replacing physical goods.’

577 Chambers (1970a, p41), ‘I have given this brief account of some twenty years’ thinking – about practical experiences, about observed financial events and about the state of accounting doctrine – simply to show that the outcome was not just a novelty. It was a conclusion to which everything
conventional accounting was clear, especially regarding the meaning of the phrase 'financial position.' Writing of Grady (1965), Chambers (1966, p250) linked his criticisms to the idea of stewardship. He questioned the use of the term fiduciary—one taken from the legal definitions found in trust law and related accounting—in a context of modern companies. To him, a balance sheet under conventional accounting might have had a function in a narrow stewardship relationship, as Whitney pointed out earlier (see 5.2.2). But times had changed.

A different report—a financial one—was required. He would however limit the ‘events and transactions’ to be included quite dramatically, especially by excluding any of an ex ante type.

Chambers had a clear view of what was to be the function of CoCoA. However, he determined that in developing CoCoA, he would have to eliminate much of existing dogma (the May legacy included). Gaffikin (2003a, p292) established that Chambers 'determined that the fundamental premises of a theory of accounting lay outside the field of accounting proper. There are four such premises; first accounting entities are collaborative systems; second, they are rationally managed, third, by recourse to current and relevant financial information; and fourth, accounting is a service function.'

pointed—provided one could only free oneself from the "sanctity" of established doctrine long enough to allow the evidence to accumulate.’ Others like Sterling (1970) and Staubus (1977) also reached this conclusion.

Chambers (1966, p252), 'It is demonstrable that the result of applying generally accepted accounting principles does not give financial position as it is understood by merchants or financiers in the market place, or even as it is understood by laymen. Let any man ask himself or another what is his financial position. He will not for a moment think of giving what he paid for his house and land, his securities and other assets.’

Chambers (1966, p250-251), 'Now the relationships of managers “to stockholders, creditors, government and others having bona fide interests” ... can scarcely all be described as fiduciary relationships, without warping the meaning of fiduciary. None of these relationships is a fiduciary relationship in the customary sense. It is no doubt reasonable to say that directors and managers occupy positions of trust, in the sense that others trust them. But not in the sense that they are trustees.’

Chambers (1966, p251) continued, 'The object of these observations is not to clarify a simple verbal point. It is to strike at the root of what seems to be an error in conception. If the accountability of management is seen as a fiduciary accountability in the usual sense, it will lend support to the idea that management is accountable in respect of the sums of money “entrusted” by equityholders, and a balance sheet showing aggregate outlays from such sums may be held to be justified; the initial costs of assets will be acceptable as balance sheet figures.’

Chambers (1966a, p136) argued, ‘If, and only if, all events and transactions, and only those events and transactions, which have a bearing on the financial position of an entity have been duly represented by entries in the accounting system, the balance sheet will represent the financial position of the entity as at the date for which it is drawn.’

Chambers (1970a, p41), ‘I concluded that only by the persistent attempt to construct a theory independently of the existing dogma, but with an open eye to commercial and financial events, could one circumvent the contradictions and inconsistencies of existing expositions and recommendations on accounting practices.

‘Old habits die hard, however.’
Regarding the first premise, Chambers identified various constituents in a firm, all of whom had satisfactions to be met while acting in markets. However, a danger was that the preparer of the report could, given the flexibility of GAAP and conventions like conservatism, usurp decision-makers' choices. To Chambers, the financial information was to assist in, not make, the choice/decision. The second premise of rationality was debated by Leftwich (1969) and responded to by Chambers (1969a). Leftwich seemed influenced by his mentor Gynther (1972), a CCA supporter, and virulently opposed to Chambers' arguments.

Gaffikin (2003a, p293) argued that perhaps economic rationality is the least controversial of Chambers premises, as it 'has been a cornerstone of much economic thought.' Stalebrink & Sacco (2003) provide some background to Chambers' use of the Austrian framework, especially the writings of Hayek and von Mises. The former made a distinction between scientific and private knowledge in economic decision-making. Both writers emphasised prices as emerging from trade among individuals or groups. The framework also referred to 'rationality' in the manner used by Chambers (1966a, p45-46).

Regarding the last two premises, from his reasoning on

- Individual Thought and Action,
- Ends and Means,
- The Environment of Action, and
- Monetary Calculation,

Chambers (1966a, p102) developed the definition

Accounting is a systematic method of retrospective and contemporary monetary calculation the purpose of which is to provide a continuous source of financial information as a guide to future action in markets.

The reference to 'financial' would become critical to the argument as he tightened the meaning to 'money equivalents'. Argument here continues in Chapter 8.

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583 Staubus (1977, p89) ties in well the decision-making (Chambers' 'choice') and the function of accounting, 'The more significant point, however, is that accounting is valuable largely because accounting outputs are useful in the prediction processes and models of decision makers, not those of accountants. Decisions always require predictions, if in no other way than to assume that the future will be like the past.'

584 Husband (1954, p11) agreed with the thrust of the argument, 'Accounting is a purposive thing. We are beginning to comprehend to greater extent the significance of this fact. There are a number of ends to be served; these are not necessarily served equally well by the provision of the same kind of data. Purpose should be used as a criterion by which the means are judged. Tradition therefore loses some of its controlling influence and logical, philosophic analysis gains in importance.'

585 Chambers (1970a, p49), 'We speak quite generally of financial statements and financial position. I suspect we often use the adjective loosely. Finance means money, cash or its substitutes. "Financial" has therefore to do with money. It seems reasonable that a financial statement should deal with money and the equivalents in terms of money of claims and other assets and obligations. The money equivalent of anything is its price. Things which have no money equivalent, no price, have no present financial characteristic.'
A point about CoCoA often misinterpreted was that it ignored ‘the future’. As Chambers’ definition above stressed, choice or action does require data of the future. While this data may be in part in the same format of position and performance statements, the key factor in CoCoA is that the data are anticipatory. Chambers would incorporate in CoCoA only retrospective and contemporary data.

At a broader level, Kaufmann (2002, p75) points out that in their financial reporting, Australian governments are guided by government finance statistics (GFS) and Australian GAAP. The former is a system of measurement and disclosure which provides data for statistical economic analysis. GFS makes complex by mixing issues from distinct disciplines - the scope of ‘financial reporting’.

Undoubtedly, to monitor effectiveness, goals/targets must be identified. These may be in (say) the form of budgets in financial or non-financial, physical quantity terms. Financial budgets may be easily structured in the format of financial performance (using revenue-expense or cash receipt-cash expenditure) and of financial position. The cross-checking provided is of course the beauty of the double-entry process (Crosby, 1997, p220). However, they remain ex ante, anticipatory figures – parts of a distinct (economic) report. Chambers would restrict CoCoA to retrospective and contemporary amounts.

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586 Berle, (1954, p41): 'Market-place judgment was rendered chiefly by investment bankers; and there as a difference of opinion whether it helped or hurt. Willingness of individuals, and bankers and institutions representing them, to invest money, is based primarily on a favorable forecast of the probable future of the enterprise. But since the future is still mercifully concealed from the knowledge of men and investors, the usual criterion for judgment is the record of past experience. This perhaps is why judgment of the market place usually tends to be "conservative."'

587 Greer (1954, p177), 'Many accountants shrink from what one of my friends calls "fortunetelling". The accountant, they say, is supposed to deal in facts, not prophecy. It seems to me that both the term and the implied concept are misleading. It is not necessary to prophecy, but it is important to make "projections" of results and financial position, based on certain "assumptions" as to volume, prices, costs, etc. Their preparation is probably the most important service an accountant can render. Let me make the budgets, and someone else can keep the accounts.'

588 Staubus (1977, p88) stressed that 'Chambers also has emphasized repeatedly that accounting deals with the past and the present, and excludes anticipatory calculations.'

589 Kaufmann (2002, p75) writes that GFS 'is developed and promulgated by the IMF and is harmonised with the system of national accounts. Australia's national accounts are prepared by the Australian Bureau of Statistics (ABS), which adopted accrual GFS from 1998-99. Last December the IMF formally released its accrual GFS framework for application by member countries... Australian jurisdictions use both GFS and AGAAP for different purposes. Taking the commonwealth as an example, the annual budget, mid-year budget update and the final budget outcome are primarily GFS based, but also include financial reports that accord with AGAAP. All budget measures (requests for new funding) and the key measurement lines (fiscal balance and underlying cash balance) are measured and reported using GFS principles. In accordance with AAS31, the commonwealth also prepares an audited consolidated financial report... In several other jurisdictions, Victoria for example, budget financial reporting in accordance with AGAAP predominates, with GFS tables provided more as a special purpose report. Likewise, in New Zealand, the accounting standards take precedence with GFS based information presented as a special purpose financial report.'

590 Some formality is now provided by the Management Discussion and Analysis (MD&A) required in some countries (Loftus & Miller, 2000, p55-59).
This would certainly narrow the context. Gole (1976, p78) argued, 'The emphasis appears to be on the non-essential, rather than the essential.... It may be far better to restrict the extent of disclosure ... and sharpen the more important things...' It is argued here that if financial position was restricted to past or current market exit prices, with other ex ante prices and calculations appearing under economic or social position, debates may be better structured and eventually resolved.

Kaufmann (p75, emphasis added), arguably in implicit agreement in the main with Chambers’ approach, concludes,

> It is well recognised that each framework has its place: GFS is an economic analysis tool and AGAAP provide a financial management tool ... Against a background of simplification, opportunities to harmonise the two frameworks, to provide one reporting framework for ex ante and ex post reporting are being examined.

If, for example, a non-monetary asset has no market exit price, under CoCoA it would be recognised but appear at zero. It may appear at an ex ante value-in-use figure on the economic statement. The definition and recognition of monetary asset or liability may require review.

CoCoA was (and remains) a very tightly developed specie of accounting. Concepts and ideas are logically interrelated. No future data (though it is used in evaluating future actions), is included. His financial position is contemporary and market oriented. Other (especially ex ante) reporting is the province of other accounting species.

This line of reasoning may explain why others continued to criticise both conventional accounting and financial reports as they ignored various economic and social amounts. These were regarded as externalities (Estes, 1996, px). Financial indicators like financial rate of return were to become paramount in the policy area (Hagan and Staunton, 1989, p125 et seq). Chambers (1966a, p321) was aware of related criticisms. Consideration of non-financial returns (of say a social type) was required. However, to accommodate such returns within CoCoA was deemed impossible. Distinct accountings – economic and social - were required.

6.3.1 Insights from the Collection

The 1960s certainly produced much questioning of reports prepared under the conventional accounting. Chambers’ ideas would be key components of various debates as well as leading to his CoCoA.

591 Chambers (1966a, p321), 'We regarded the firm as an instrument by which its constituents see to increase their satisfactions. Under interdependence, what is sought is increase in the generalised means of obtaining satisfactions, not merely greater command over monetary tokens as such.'

592 Material referred to in this sub-section is generally from the researcher’s own files developed over the years. They are not of course as complete, carefully catalogued nor cross-referenced as those in the Collection. However, materials referred to are also found in the Collection, to which interested parties are recommended. For example, Chambers (1963a) is USA P202, Box25, #8354.

593 Chambers (1970a, p40), 'Fortunately for me, there was evidence in Australia to the point that the long-established doctrine of conventional accounting – the initial cost doctrine – was not in fact
As in many debates, the original cause perceived among writers can vary as often causes can be multi-dimensional. Debate resulted from a report (Anonymous, 1963b) which (among other themes), questioned the ‘general quality of published financial information.’

Sanders (1963) responded that the problem was in lines of collusion amounting to fraud which led to financial statements which were neither fair nor reasonable. In response, Chambers (1963a) argued diverse accounting rules adopted by management made comparison invalid. As well, the monetary terms used were of a different order so their addition and resulting manipulations led to illogical data. His solution was CoCoA where rules were devised to make comparison valid.

Later that year, a talk by Urquhart (1963) in the context of governmental intervention regarding a SEC type body (met in 6.2.3), was reported. Chambers responded (1963b), arguing this was counter-productive as the then companies laws in principle had sufficient power. However, despite these laws, it remained impossible to compare the financial results and positions of companies. What was required was financial information with the qualities of contemporary realism and comparability. If this was provided, valid inferences would be able to be drawn.

Green (1963) found Chambers’ comments ‘surprising and disturbing’. He argued – following the May legacy - companies had the right to account for their financial and operating results provided they complied with GAAP. These principles had evolved from experience gained over many years and had been generally accepted by the financial and commercial community. A set of inflexible rules were unnecessary. As well, most Australian companies were honest in their accounting, using principles developed and accepted by the best brains in the financial and commercial communities of Australia and all other progressive countries. Arguments were similar to that of May and his ‘conventional accounting.’ By inference, Chambers was not one of those ‘best brains’.

Chambers (1963c) persisted. Using the qualitative standard of ‘true and fair’ if interpreted in a non-technical manner, he argued corporate law was premised on those contracting with a company being given access to knowledge of the company’s condition and results. This knowledge was to be presented in financial statements. The reference to a contract between management and shareholders of a company was not new, of course. It underpins the managerial theory of the firm and agency theory with its ‘nexus of contracts’ (Chambers, 1993). Chambers arguably uses it in the context of a broad fiduciary relationship.

endorsed and followed in practice. Poring over company reports, prospectuses, loan indentures and press reports, I found that this evidence was substantial.’

594 Chambers did correspond with May in the 1950s (USA P202, Box 24, #8373 to #8376). May considered the ‘time is not opportune to attempt to state or restate a general accounting theory.’ Chambers (1955, 1957), however, was not discouraged and continued his work on CoCoA.

595 Chambers (1963c), ‘If the law is so loose, or if the general acceptance of the principles it presumes does not exist, then the law is, for practical purposes, meaningless.’
Chambers continued (1963d) to emphasise the difficulty met by investors when faced with flexibility in financial statements for different companies. Information may be denied on which investors and creditors could choose. Over time eventual losses may become more serious.

Provisions of the then new Companies Act, Chambers (1963e) pointed out, still took no step to make the information published by different companies comparable. He proceeded, by way of illustration, to show how results as given by GAAP could be contrary to commonsense which no intelligent person\(^{596}\) would accept. As well, he (1963e) raised the difficulties under the requirements of the Companies Act caused by the word 'amount' which was open to wide interpretations. The amounts of items in a balance-sheet could be determined in many different ways, especially under conventional accounting.

He concluded while the statutes continue to permit

- diversity, and
- the adding of qualitatively diverse things to give a "true and fair view",

the state of a company’s affairs as at the date of the balance-sheet would be known only by chance.

The situation was compounded by the possibility of management over time to change the accounting principles used in preparing financial statements. Arguably, management might choose principles to produce the results it would like to report.\(^{597}\) Obviously, there were errors in the underlying philosophy of conventional accounting.\(^{598}\)

Issues were given academic rigour in the 1963 annual endowed lecture of the ASA in which Chambers again questioned the then current practices of accounting.\(^{599}\) Staff Correspondent (1963) also commented on the address, restating Chambers’ argument that accounting and related financial reporting had ‘an extensive impact on incomes, employment, and the development of industry and the distribution of economic power.’ For an observer to be able to assess a financial report in an informed manner, it was argued that two fundamental conditions were necessary,

- general comprehensibility, and

\(^{596}\) Perhaps it might be argued that such common sense ideas, while appealing to an ‘intelligent person’, were easily ignored by an ‘intelligent accountant’ who relied on conventional GAAP.

\(^{597}\) Chambers (1963e) concluded, ‘Thus, although comparative figures are to be shown, their comparability may be open to serious question. If the precise nature of any changes adopted in a year, or the magnitudes of the effects of such changes, were required to be stated, a user of the statements might be able to make some rough adjustments to the figures of the previous year to make the two sets of figures comparable. But on the face of it the Acts do not provide this opportunity.’

\(^{598}\) Chambers’ arguments, written in the semi-professional literature under the heading ‘Traps For The Unwary Investor’, also included 1963f and 1963g.

\(^{599}\) The address was titled ‘Financial Information and the Securities Market’ and commented on in a separate article (Anonymous, 1963). A related paper was later published in full in the academic literature (Chambers, 1965a).
correspondence or isomorphism.

As evidence of the first formal condition, Chambers used the various methods available to the preparers of reports under conventional GAAP to calculate the many ways possible to report inventories, long term and other assets, the consequence from which was a lack of general comprehensibility.

This empirical evidence of the potential consequences of the array of 'rules' available was published in the academic literature. In his commentary on Grady (1965), Chambers (1966, p256) suggested some regarded his argument as useless, but he responded that the criticisms missed his main point - the effect on various stakeholders' interpretation of financial statements. As seems so often the case, debate was at different levels or at cross purposes.

As evidence of the second fundamental condition, Chambers used various Australian takeover bids. He saw weaknesses in the information made available to shareholders, especially as regards asset values.

His argument was further commented on by the Staff Correspondent (1963). It was agreed that the rapidly expanding influence of the accounting profession since WWII had come from the increasing complexity of the modern world and the greater emphasis on accountability. Unfortunately, universally acceptable accounting practices and underlying accounting theory had failed to keep pace.

Indeed, complexity in business had increased which made more urgent the need for accountability. However, AAP and the underlying theory were not up to the task. If the end product of the accounting process was the main, or only basis, for important investment decisions, the many acceptable ways in which such accounts could be prepared might seriously undermine the value of these decisions - to the point where they were little more than a gamble.

The context was one in which financial reports were to be used in decision-making by a range of stakeholders, from 'the small investor to Government policymakers.' This was reinforced by Anonymous (1963a). A series of issues arose:

- Was a set of comparable accounts possible?

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600 Chambers (1966, p256), 'The purport of the exercise is not to indicate that an astronomical range of possibilities is open to any specific business or to say that an astronomical array of results could be obtained for any specific business. Its object is to show that, as the range is so vast and the results may be so divergent, any user of the resulting statements cannot know what precise set of methods has been used and cannot therefore know with what provisos he must accept any of the financial statements of different companies he may wish to consult at a given tine to inform his choices.'

601 Chambers (1965a, p193), 'Any bid substantially above the market price appears to be a clear indication either of the inadequacy of the management in the past, or of the niggardliness of management in the past in giving information to shareholders. On neither count can it be suggested that shareholders have been well served. On the other hand, it may well be suggested that niggardly reporting is a device which serves to veil the inadequacy of management and directors, whereas one might expect that a form of communication required by law would serve to unmask inadequacies and inefficiencies without the necessity of a takeover bid as a catalyst.'
• Was the balance sheet simply to show unabsorbed costs to be allocated against the revenues of succeeding periods or a valuation statement?
• Was the maintenance of the company’s original capital to be the prime consideration?
• How were current price levels to be incorporated into financial reports?
• Did inflation affect the effectiveness and usefulness of historical cost accounting?
• How could any potential financial strain on a company in the replacement of assets in times of rising price levels be incorporated?
• Would supplementary accounts resolve the problems?

Various debates were certainly being recycled.

In his argument, Chambers referred to overseas developments (UK, USA, the Continent and Finland) and used illustrations from Australia (the Custom Credit case, mining industry practices and large company failures in the then recent years). Using the legislative requirement of a ‘true and fair view’ to be reported, it was (Anonymous, 1963a, p17) suggested, ‘A wide and sweeping scientific inquiry should be made into the bases of accounting principles ....’ This would include ‘the establishment of an independent financial research foundation to inquire into contemporary (ac)counting.’

Response in the semi-professional literature was at best mixed. York Seymour (1963)602, while agreeing that Chambers’ address met the objective of being provocative, took issue with the argument regarding

- balance sheet values
- use of market prices
- take-over bid price
- sample selection
- disclosure.

The debate here was not well structured, but does highlight the dilemma Chambers faced in his search for scientifically developed AAP and his strict use of the term ‘value’.

602 York Seymour (1963), ‘The great weakness of Professor Chambers’ argument is exposed when he attempts to define the degree of unknown variation in balance sheets values. For this, he relies on his table of information of takeover bids.

‘Professor Chambers’ argument from this table is that the market prices of certain companies indicated limited public knowledge of those companies’ values, while the takeover bids indicated the true or unrevealed and privately known values....

‘Professor Chambers has excluded from his list all Reid-Murray takeovers and Latec takeovers and other similar series of takeovers, because they obviously would not support his argument. However, even on his own too-short list there are some which (less obviously) do not support his argument.

‘The proof of the pudding is in the eating thereof. The proof of the takeover value is in the digestion of the takeover....

‘Professor Chambers, therefore, has not offered a full list nor does he offer any critical analysis or evaluation of the values in the short list of takeovers given. Surely this amounts to the fact that he has fallen into the errors he complains about — that is, non-disclosure of some values and wrong disclosure of given values.’
Barnes (1963, emphasis added) also questioned the link between reporting of market prices in financial statements and the share market price. He concluded,

> However sympathetically one may view Professor Chambers’ thesis as a whole, it is difficult to accept that the premium value of a takeover bid necessarily reflects upon the financial reporting of the subject company.

Again the debate is not well structured. The use of ‘necessarily’ gives Barnes the point but equally Chambers does not argue at that level.

Burke (1963) essentially made this point in his basic agreement with Chambers, including the ‘evidence’ debate. The exchanges show the importance of explicit hypotheses if debate at cross-purposes is to be prevented.

This period saw further interest in the reported losses by companies and in some cases their failure for various reasons which in turn were the subject of official investigations. These included Garrison Industries Ltd, the Ducon case, the Moulton group, Sydney Guarantee Corporation, Stanley Korman’s Stanhill empire, the Latec group, the Reid Murray group and later the H G Palmer case. The situation was summarized in Anonymous (1964). The Bulletin included the usual topics met earlier in this section. In the semi-professional literature, Staff Correspondent (1964) referred to the Bulletin, stressing the criticism of auditors and trustees in the context of the ‘true and fair’ issue.

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603 Barnes (1963), ‘It would be idle to deny that there have been cases of inadequate financial reporting which have resulted in depressed markets for the shares concerned. ‘It would be equally idle to contend that market prices for shares are closely correlated to published results, for their fluctuations are often extreme and baffling to the observer. ‘The mere fact that there is a wide margin between the market value of shares and the market value of a takeover bid for them is not necessarily evidence that the financial reporting of the offeree company has been inadequate, it is submitted that Professor Chambers is not entitled to draw his contrary conclusion without adducing further evidence.’

604 Burke (1963) argued, ‘If a research worker is able to demonstrate by factual evidence that present beliefs may not necessarily be true, he is entitled to infer the falsity of those present beliefs or standards of acceptance. ‘The sample given by Professor Chambers was wide enough to question the adequacy of existing practices and indicate that investors are not provided with full and fair disclosure... ‘Nor do I know whether Mr Seymour is satisfied with present methods of financial reporting. He does not tell us. ‘However, if he thinks the generalisation made by Professor Chambers is unsound, then I suggest he collect a range of balance-sheets within an industry of his choice. ‘Then, having made a detailed analysis from the information disclosed from the balance-sheets, it is necessary for Mr Seymour to ask himself whether it is possible to make meaningful comparisons between each company. ‘If the answer is in the negative, he must surely agree with the generalisation made by Professor Chambers. ‘If in the affirmative, then presumably we can only agree to disagree.’

605 At that time, the Current Affairs Bulletins, published by the Department of Tutorial Classes in the University of Sydney, with the author remaining anonymous. This, this researcher recall hearing it said, (admittedly hear-say evidence and therefore of little if no help in argument) was for ethical reasons whereby persons including academics wrote to make comments on current affairs available for the general public rather than writing for their own career purposes. While Chambers did not claim it at that time, it was rather easy for some to see his mark on it. In any event, Chambers did publish it under his own name (1969, p204-219). The final page of the 1964 one was excluded in the 1969 publication – probably due to space constraints.
The issue of the interpretation of ‘true and fair’ continued to be recycled (Horrocks, 1967; Ryan, 1967, 1974; Editorial, 1969; Miller, 1969; Barton 1972, 1974; Gill, 1983). Spacek (1969) wrote of the tensions found in the USA regarding the similar idea of ‘fairness’. Ryan (1985) later argued for the deletion of the phrase, emphasizing instead reliance on developed accounting standards. Walker (1986) disagreed, showing the need for an ‘over-riding’ regulation. This issue is returned to in 7.2.3.

Over the years, Chambers (1966, 1966a, 1973) would return to this issue. Issues and related debates are found in Chambers and Wolnizer (1990, 1991). The interested reader might prefer to read the articles in reverse order. In the 1960s, a related debate is found in which Chambers ideas were included.

The relationship between the most respected insurance company (MLC) and the retailer (H G Palmer, which was to become one of the more spectacular corporate failures of the 1960s), raised issues in different areas and at distinct levels of abstraction. Issues found in a series of Editorials (1965, 1966, 1966a) were wide-ranging. The first included the possibility of disharmony at the board level of companies and related professional disputes. Of concern here was the use of the name of MLC in the prospectus of an associate – H. G. Palmer (Consolidated) Ltd.

Impressions of support by MLC were implicitly suggested, but in actuality there was no guarantee given. This led to a dilemma faced at the ethical (as opposed to legal) level.

The second editorial questioned the function of accounting information and its quality, but raised mainly issues concerning institutional tensions. While the

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606 Chambers (1966, p234-244), in his commentary on Grady (1965) and the case of the USA (where the phrase was ‘fairly present’ rather than ‘true and fair’), ‘It seems therefore that insofar as the law is superior in effect, as representing the will of a whole society, no discussion of the responsibilities of C.P.As which neglects or passes over statutorily imposed duties can be complete. Now the law does indeed lay specific responsibilities on C.P.As. The Securities Act and the Securities Exchange Act regulate the affairs and the reporting on the affairs of certain corporations “in the public interest and for the protection of investors.” There can be no rule of the professional body which has authority in derogation of this statutory principle. It may transpire that, on the occasion of a dispute, the courts are required to interpret the principle; but the principle is in any case stated as a rule of general behaviour.’

607 Editorial (1965) continues, ‘One of these issues is the use of great financial institutions’ names on the prospectuses for associate companies’ borrowing operations....

‘There is no guarantee involved in this. But the association is undoubtedly publicised to give the lender the impression of security and solidarity given by the bank....

‘... the fundamental question remains: what does the connection between the bank and the finance company really mean in terms of security to the lender? If some form of backing is implicit why should it not be made explicit?...

‘Although in certain circumstances the holding company directors may feel a moral responsibility to do something in the interests of creditors of a subsidiary, it may well be held that they should only do so if it is in the best interests of the holding company shareholders.’

608 Editorial (1966), ’The 1960s have not so far been a happy decade for the accounting profession....

‘While their shortcomings have been very much in the public spotlight in the past few years, it is too often forgotten that the prime responsibility for company performance and reportage of that performance to shareholders, trustees and other interested parties remains with the directors.'
responsibility for financial reports of companies lay with the directors, the argument was centred on accountants and their profession, partly because directors lacked a professional body. An examination of these bodies and the exercise of power therein was an institutional issue, as was the role of large shareholders and effects of an accounting for small shareholders.\footnote{609}

The third editorial (1966a) was of a more information-type tension, involving some creative accounting in MLC reports to deal with losses resulting from the investment in H G Palmers.\footnote{610} Questions were raised as to the standard of true and fair. The argument was to be extended to other cases. The debate\footnote{611} became entangled within various issues which were recycled for decades, including,

- a balance sheet or a statement of financial position,
- the use of historical cost or current prices,
- the role of the auditor.

The editorial introduced, as well, the issue of price level accounting, including the reporting of contemporary prices and their movements.\footnote{612} The pot was stirred, and

\begin{quote}
'The public focus has been on the accountants-auditors partly because in the Chartered Institute and the Society of Accountants they have responsible bodies to examine and regulate the standards and performance of members, although some might claim these powers have not been used strongly enough in the past.

'But there is no such cohesive body for directors.'
\end{quote} 

\begin{quote}
\footnote{609} Editorial (1966) continues, 'since the fate of so many small shareholders is really in the hands of a few large shareholders and their boards of directors, the doctrine of maximum disclosure of company results and contracts becomes more important than ever in order that companies are not only well run but can be seen to be well run.'
\end{quote}

\begin{quote}
\footnote{610} Editorial (1966a), 'The neat accounting solution to the M.L.C. Ltd. Group's losses in H. G. Palmer (Consolidated) Ltd. re-emphasises the semantic problems of the accounting profession itself. In The M.L.C. Ltd.'s accounts the H. G. Palmer losses have been absorbed by writing up the book value of the company's shares in the Mutual Life and Citizens' Assurance Co. Ltd. Valued in the books at $6 million last year they are now shown at $14.5 million – and, as the directors point out, they are probably worth much more than that. 'But where does this leave the “true and fair view” attested by the auditors for both years?'
\end{quote}

\begin{quote}
\footnote{611} Editorial continues, 'The M.L.C. Ltd. Balance-sheet is only one example of the problems of the “true and fair view” of principal asset values in company accounts. There are some in which the differences between current book value and the values to which assets could be written up and still be conservative would be far more dramatic than that shown in the M.L.C. Ltd. case. 'But is a book value which is half an asset’s current worth any truer or fairer than a book value which is twice the current worth? Certainly the understated value is the safer one. But auditing certificates do not deal with safety, or at least the accountants assure us they do not. 'There is in fact a ground swell in the accounting profession for a more realistic approach to the valuation of accounts in annual accounts. 'This would involve the statement of balance-sheet values at current prices rather than historical cost prices.'
\end{quote}

\begin{quote}
\footnote{612} Editorial (1966a), 'But the price level accounting protagonists are concerned with much broader issues than the accounting problems thrown up in recent years which have mainly been associated with credit control. 'They are concerned with the “true and fair” concept in its broadest sense, arguing that complete current valuation accounting is as necessary for sound internal management as it is for realistic external assessment of a company's investment worth. …
\end{quote}

207
Chambers was explicitly (through his own writings) and implicitly (through writings of his students and colleagues) involved. While often seen as concerning the meaning of a 'true and fair view', issues at different levels were to surface.

Ferris (1966), then a final year honours student in Chambers’ Department, responded to the Editorial (1966a), arguing the need for contemporary prices and their movements to be reported.613

Forster (1966), an academic and practitioner who did not support Chambers’ system or underlying reasoning, responded, arguing for statements supplementary to the conventional ones, to be provided to meet the ‘dual problem of providing a true and fair view, and securing the most effective communication of a company’s position and results…’. He preferred conventional accounting, not the idea of a company faced with a rapidly changing environment in which such changes were to be reported.514 He attacked the use of ‘a break-up value’, thought a true and fair view was ‘already defined well enough in the general or common law’ and argued the claim for a more precise definition was simply a scare tactic. He then attacked Ferris rather personally.615

Baxt et al (1966), academic colleagues of Chambers, commented on both Ferris and Forster616, and after citing Chambers’ work on alternative methods available, concluded, ‘We believe the term can be usefully defined, but progress in this direction

‘Whatever the merits of that broad front charge the easy write-up and the tragic write-downs in the M.L.C. Ltd. Accounts this year should stir the debate between the conventional historical accountants and the radical current-value accountants as to when a “true and fair view” is really true and fair.’

613 Ferris (1966), ‘The purpose of this letter is not to point the finger at M.L.C. Ltd., but rather to stress that if the “true and fair” provision is to play its social-protection role as intended by the original legislators, it must first be operationally defined…

‘… one may hope that “truth” in accounting will be defined by the protagonists of current price accounting and act as their guide during the greatly delayed debate with the traditional accountants.’

614 Forster (1966), ‘With all its faults, however, the broad base of historical cost must be retained in order also to retain the accountability of management for every instance where it departs from that base.

‘We have seen a sufficient number of instances of sharp and sudden changes in value, not least those brought about by changes in market demand, to appreciate why it is that neither the American or the European, nor the English or the Australian profession have felt it desirable to abandon that approach to reporting.’

615 Forster (1966), ‘Mr Ferris’s comment is ill-informed, and uses ugly, inappropriate, and irresponsible words…

‘To throw in the odd exculpatory phase simply is not good enough; but youth, lack of practical experience, and a shaky grasp of the law may excuse, in part, an unwarranted attack on the integrity of the M.L.C.’

616 Baxt et al (1966), ‘…the Courts have been unwilling to define the term “true and fair,” or similar terms in previous legislation.

‘They have not provided an operational meaning of the term by specifying procedures that must be applied in order to give a “true and fair” view.

‘Instead, they have left the formulation of rules of procedure for arriving at this view to the accounting profession…

‘Regrettably, the significance of this definition is limited by the wide range of alternative procedures recommended and by the discretion allowed the individual accountant in applying them.’
can be achieved only if accountants abandon their defensive attitude and admit the deficiencies of extant practice.'

Ferris (1966a) kept the debate alive, suggesting Forster had misread the argument. After restating his case, he concluded, 'The fault lies not in the conduct of the M.L.C. directors but in the accounting and legal framework within which these and all other directors work. The problem is not a particular one but a general one.' Both institutional and information tensions were in play.

Forster (1966a) took issue with Baxt et al and reengaged debate with Ferris. As regards the former, Forster thought their argument lacked justification. As regards the debate with Ferris, Forster relied on the then legal provisions. Indeed, he argued, both their arguments represent merely a Jason-like quest for stability and the absolute; a vain attempt to banish change or fluctuation, in short, a flight from reality.' Instead, he suggested, along the lines of May's legacy, an education approach, although this time of management. He did cede a need for improvements in various areas. His end was similar to that of Chambers. However, he disagreed concerning methods of improvement and probably as to what needed to be done.

Final year students from Chambers' Department, Hewson et al (1966), continued the debate. Forster (1966b) suggested their argument contained distinct issues which required independent consideration. He restated his comments on definition and the role of 'generally accepted' practice which may 'to a degree ... frustrate the intentions of the legislature.' However, in line with the May approach, he saw these as being overcome by education and ethics. Rather surprisingly to some, he referred to a 'new breed' of accountants.

617 Ferris (1966a), 'In spite of Mr A. Forster's years and practical experience his letter ... achieved only two things: (1) It successfully and completely missed the main point of my letter ... and (2) it unsuccessfully defended historical cost as a basis for accounting.'

618 Forster (1966a), 'Just how one goes about abandoning the law is not clear but, in any event, it is a quite irrelevant proposition which tends to confuse the public law with private purposes and to sandwich the accounting profession in between.'

619 Forster (1966a), '... there was little justification for attacking a company on the basis of a subjective difference of opinion about what the legislation has seen fit to enact as the law, and what some other people think the law should be...'

620 Forster (1966a), 'The answer lies along a longer and a harder road - a wider and more intensive education of accountants and, eventually, the winning of management acceptance - by persuasion (sic), not by criticism.'

621 Forster (1966a), 'There remains however a need to improve and to strengthen the law, a need to improve and strengthen accounting so that it may become a more effective instrument of communication, and a need more effectively to share our knowledge and our awareness of these needs with management; not, may I repeat, by criticism, but by persuasion and the more normal educative processes.'

622 Forster (1966b), 'It is quite obvious that a number of separate elements, associated with the expression or communication of a true and fair view, are being mixed quite indiscriminately ...'

623 Forster (1966b), 'There is a growing body of responsible public and professional opinion that gradually will become an effective force - bringing about the desired changes in understanding, in outlook and in practice.'
The same issue saw the continuation of the debate. Chandler (1966), another final 
year student, cited Littleton (1953) to question links between truth in financial 
statements and GAAP, arguing ambiguity and inconsistency in GAAP misinformed 
readers. To Chandler, conventional accounting did not produce a ‘true and fair 
view’, which in part was the cause of unexpected corporate collapses.

Stewart (1966) implicitly agreed, using an analysis of ICAA (1965), which 
emphasised the consistent application of GAAP, to suggest the use of ‘true and fair’ 
was at the least redundant. However, he also suggested “that the fault lies in the many, 
varied, and conflicting, “generally accepted accounting principles”.”

Hewson (1966) responded to Forster, arguing again problems arose from flexible and 
inconsistent GAAP, not the law. After supporting Chandler, Hewson continued that 
the reformation of GAAP was indeed a lengthy, difficult task – probably a case for 
Forster’s ‘new breed’ accountants. Forster (1966c) responded, complaining of

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624 Chandler (1966), ‘(1) The professional accountant is concerned, basically with the presentation of 
“truth,” which “in vacuo” is apparently impossible to define. 
(2) In any practical situation the accountant must look to accounting principles and standards to determine “truth.” 
(3) If accounting principles and standards are ambiguous, misleading and not consistent with one 
another, any attempt to discover or present the “truth” will be in vain. 
(4) Failure by accountants and other members of the public to realise the shortcomings and limitations of present accounting systems and terminology will lead to “misinformation.” 
(5) The statement by an auditor that the accounts present a “true and fair view” does not necessarily 
mean that the data are dependable or that the information is reliable: the “full truth” may not be 
presented, “and skilfully concealed error in the accounts” may be present. Recent company “disasters” 
in Australia reinforce the view that such is often the case.’

625 Hewson (1966), ‘[Forster] places the onus, for the initiating force of reformation, on the shoulders of the legal profession, but surely this is placing “the cart before the horse.” Good practice must necessarily precede the law and so, in my opinion, the onus should lie with the accounting profession. 
The basic deficiency, at present, is to be found in the notion of so-called “generally accepted accounting principles,” and it is on the basis of these that the professional accountant expresses his opinion on the “truth” and “fairness” of financial reports.’

626 Hewson (1966), ‘Many people who are under the impression that an adequate body of principles does exist probably have in mind the “Recommendations on Accounting Principles,” but these contain only fragmentary statements on selected topics, not a coherent set of principles. Comparing the financial status or performance of several companies is an extremely difficult task under the best circumstances. But when the figures for the several companies are prepared under different ground rules the task is even more frustrating.... 
‘If they differ it should be because they interpret the facts differently, not because they are applying different principles. This goal of course isn’t quickly or easily attainable but it should be the goal and accountants should be dissatisfied if continued progress is not being made toward it.... 
‘To meet this need should be the aim of accounting’s “new breed.”‘
being misquoted. His argument was stated to be within the context of current legal provisions, not with GAAP. 627

The argument was overtaken by issues to do with the auditor rather than with the actual financial reports. 628 Despite problems still not being resolved, other issues were instead debated, including

- the place of world-wide accounting firms,
- lawsuits against accounting firms,
- the resulting increase in insurance premiums,
- the threat of the SEC developing new rules of its own for the profession including whether lucrative consulting services formed a conflict of interest, and
- the effect on independence of the external auditor.

Recycling of issues persisted.

6.4 Related debates and their resolution

Various themes are possible to structure various debates, like those above. Here, the argument seeks to be consistent with Gell-Mann's (1994, p9) studies of 'the simple and the complex' through the emergence of 'complex adaptive systems' (CAS). He contrasts laws of elementary particle physics with subjects like linguistics and natural history — leading to an interdisciplinary approach. The former are thought to be exact, universal and immutable even though scientists have to use successive approximations. The latter are concerned with languages and species in general and with words and organisms, including human beings, in particular. Here the laws are approximate. He also showed as much concern with a chain of relationships as with the laws themselves. While some argued that the business entity and the related accounting were non-adaptive systems, part of the May Legacy, Chambers would question such assumptions.

Features that distinguish CAS are only implicitly of concern to this thesis. Once accepted, debate begins at that level. Chambers certainly adopted the idea that CoCoA is a CAS as is the entity for which reports are to be prepared. However, tensions were

627 Forster (1966c), 'Mr Hewson presents an inaccurate and misleading version of my views, and consequently a quite invalid argument....

'What he has to say about "principles" is interesting, but not relevant to my original and central purpose....

'I wrote, primarily, about the law as it is, not as we would wish it to be. Subsequently, I made it clear that I was well aware of the broader issues....

'I admire his temerity, but I cannot respect his judgment. He has, however, my earnest good wishes — so long as he realised that I am not involved in the debate about "generally accepted accounting principles.”"

628 Editorial (1966b) included, 'Inevitably, after the big group crashes, problems the Australian profession has had to meet in recent years have been largely focused on the audit and management of the accounts of large groups of companies.

'But there is also a vast twilight area in accounting where strong guidelines are needed but where at present items and terminology can mean practically all things to all men.

'Often it is impossible to compare with any meaning at all the results of one company with another in the same business or even to compare a company's results one year with its results in previous years.

'The malleability of many accounting concepts remains one of the most difficult problems for the profession.'
(and are still) caused by a failure to define financial reporting succinctly. It presently mixes ideas from different disciplines necessary for informed choice. As well, the idea of accountability in the context of stewardship must be incorporated.

The choice/decision-making dilemma is usually discussed in the literature in terms of effectiveness and (productive) efficiency. Equity is seen as being of a different order, though issues here are met implicitly in various discussions. Concepts may be grouped into those concerning equity/welfare economics/social issues, efficiency (both allocative and productive) and effectiveness. Reference is sometimes made to economy. Figure 6.5 shows how the above interrelate.

Figure 6.5

At the general policy-making level, issues involve the allocation of scarce resources among competing demands and questions of social equity among parties. It is found in macro-economics and other social sciences. Here, some analysis and related data will certainly be qualitative and non-financial.
At the application level, allocative efficiency, from micro-economics, seeks the optimum combination of inputs (factors of production) for the required output. Productive efficiency, again from micro-economics, is also found in engineering and other disciplines. While different disciplines have different definitions, it basically deals with the optimum relationship between inputs and outputs. If inputs are given, maximum output is sought. If output is given, minimum inputs are sought. Effectiveness deals with the relationship between planned output and actual output. Economy deals with the relationship between planned input and actual input. For instance, management may be able to achieve a favourable variance re materials and an unfavourable variance re labour hours.

As mentioned earlier, the stewardship dilemma may be of a narrow or broad nature. The argument that follows is summarised in Figure 6.6.

**Figure 6.6**

<table>
<thead>
<tr>
<th>Data</th>
<th>Conventional</th>
<th>Financial</th>
<th>Economic</th>
<th>Social</th>
</tr>
</thead>
<tbody>
<tr>
<td>Decision-making &amp; Interdisciplinary issues</td>
<td>By chance</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>- Effectiveness</td>
<td></td>
<td>Yes</td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Efficiency</td>
<td>By chance</td>
<td>Yes</td>
<td>Yes</td>
<td>Perhaps</td>
</tr>
<tr>
<td>Accountability &amp; stewardship</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- Narrow</td>
<td>Perhaps</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>- Broader</td>
<td>By chance</td>
<td>Yes</td>
<td>Perhaps</td>
<td>Perhaps</td>
</tr>
</tbody>
</table>

In the following sub-section, an interest in accounting (in Chambers’ generic sense) at distinct levels is here termed ‘interdisciplinary influences’ on that accounting.

**6.4.1 The influence of interdisciplinary studies on accounting**

Tensions here were reinforced by issues of effectiveness and efficiency in both the public and private sectors. Effectiveness and efficiency may be defined and applied to all types of inputs and outputs - conventional accounting, financial, economic or social. For example, ‘effectiveness’ may be defined as the meeting of set goals; the goals may be set in terms ranging from financial to social. What is important is that any definition is consistently applied if tensions of accounting in general and of liabilities in particular, are to be resolved.

As found in earlier Chapters, discussion of the influences of other disciplines on accounting is not new, being certainly found in Chambers' writings on CoCoA. It is well known that Pacioli’s treatise was part of a text on arithmetic. Canning (1929)
thought ‘the study of accounting should be structured on the three pillars of mathematics, law and economics…’ (Zeff, 2000, p18).  

Accountants and their discipline certainly had to face new ideas and challenges. Improvements in inter-personal and inter-disciplinary communications, in access to data and in computers provided impetus for better techniques for mapping, modelling or planning. As well, new financial instruments have been created and developments have occurred in economics like ideas on risk analysis. However, as Gaffikin (2003a, p307) points out, accounting continues to face tensions with other disciplines. Some years earlier, Most (1984, p31) suggested these included those involved in data-management systems and annual report preparation.

Incorporation of influences like these has interaction with accounting – internal reporting (the province of cost/management accounting) in the first instance and then external reporting (the province of financial accounting) – and provided a challenge for accountants. Gaffikin (2003a, p307) argued that issues of application were still not in harmony with an underlying reasoning. He questions whether capital market and agency theory based research have eased tensions previously researched by the a

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629 Gaffikin (2003a, p291), writing of the 1960s, suggests ‘Accounting researchers, it seemed, were now more conscious than ever of the intellectual basis for their discipline.’

630 An illustration is found in the water industry where, up until the mid-1980s, the development and application of financial systems and the wide range of operational and technical systems took place in isolation. Arguably, tensions at the professional and discipline levels played a part. Relationships between various groups – say between the engineering group and the corporate services group (including accounting) - as well as within a group – say among human resources or accounting or marketing – saw unresolved (and possibly unresolvable) debates. These tended to be more concerned with defending a sectional interest or avoiding responsibility for an error by fixing the blame elsewhere. See also Murray (1989).

631 At the local government level in Australia, the accountant (of no particular persuasion) and the engineer now have to work together to produce reports including information on water and water-related issues. The data reported in an annual report are much different from the matter and methods previously used. Instead, emphasis is placed on merging the two streams as the data is taken from a common system. For instance, The Sydney Water Board annual reports reveal major changes in 1983 (Staunton et al, 1989, p117-121).

632 Gaffikin (2003a, p307), ‘The discipline of accounting has not fared well in the new millennium. It is probably facing the most severe crises in its entire history. First, there are questions of relevance in an age in which there are sophisticated electronic information processing media that can manage what many see (probably incorrectly) as the major functions of accounting.’

633 Most (1984, p31), ‘The development of database management information systems is gradually moving the accounting function out of the accountants’ hands. In many large corporations, the preparers of financial reports already accept their data and accumulations from a computer that they do not program, that uses definitions prepared by systems analysts and measurements devised by statisticians.’

634 Williams (2003, p252-253) laments, ‘Since accounting is a social practice and not a social science, there is no necessary reason to believe that any mode of analysis would have a monopoly on providing understanding. Indeed, one might expect a multi-disciplinary eclecticism in accounting scholarship; it would be opportunistic in adapting many disciplinary insights to its purposes (as medicine increasingly does). This has not turned out to be the case.’ Neu (2001) argues in a similar fashion.
priori researchers, especially as both human behaviour and the modern economic/business environment remain exceedingly complex.  

How was any complexity to be incorporated? Were the boundaries of accounting to be broadened? Chambers preferred a narrowing of financial reporting to his tightly defined CoCoA. However, the resulting financial statements had a set function (Chambers, 1976a) within a broader, more complex economic behaviour, which in turn were placed within a still broader social behaviour. Chambers (1991b) would later support his argument with a series of foundations of accounting.

Little argument would be found in the recent literature on there being an interaction among accounting and interdisciplinary studies. However, where accounting fitted into a spectrum of disciplines would be debated. At one extreme - a narrow view of accounting - one would find conventional accounting which provided Peloubet (1935, p203) with the 'actual record' of an amount. He did not challenge the 'utility' of the reporting of various 'values' – they may be 'much more useful than the actual record' found in conventional accounting. On one hand, he saw 'financial reports and accounts'; on the other 'statistical projections backward or forward'. However, the former was the key as it was required for the latter to be developed. He also argued against Ripley's claim (4.2) that the balance sheet was 'an instantaneous photograph' and the secondary role given the income account. Both claims were 'fundamentally false'. This he argued might be true in the limiting case when

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635 Gaffikin (2003a, p307), 'The research and theorizing that supplanted the a priori work of the sixties was heralded as providing a more meaningful and realistic appreciation of accounting and business behaviour. The emphasis was to be on understanding and prediction and this made regulation unnecessary as the market operation would solve all "problems". Is there a high correlation between such thinking and the crises now facing accounting? Whether or not there is such correlation, the behavioural assumptions underlying this theorizing is simplistic. The lack of agreement between the a priorists is an indication of the complexity of human behaviour - the assumptions made in the beliefs that they reflected business behaviour. The complexity and understanding in social/business behaviour is part of what some have referred to as the postmodern condition. In such a state most attempts to produce a theory fail. The general theories of the a priorists fail because there are no universals. The theory of those who came later attempted to narrow the field of study with the emphasis on mainly one type of user of financial reports taking their theories even further away from the complexity of the modern economic environment - or should that be the postmodern business environment?'

636 As suggested by say Accounting Standards Steering Committee (1975); McMonnies (1976). Others would debate the need for 'new' statements (Myers, 1971, 1971a; King, 1971; Littrell & Cox, 1971).

637 These include: Commercial, Legal, Economic, Financial, Metrical, Psychological, Axiological, Organisational, Linguistic, Social and Data processing.

638 Peloubet (1935, p203), 'anywhere on the scale of change an economist or a statistician could plot a number of curves backward or forward from any point of time to show from that point the effect of the continuance of the values selected or the effect of any assumed change. Such a graphic representation might be of great interest and utility – it might be much more useful than the actual record – but this representation could not be made without the actual record and could not in any way take its place. Here, I think, we have the basis of the general opposition between financial reports and accounts and statistical projections backward or forward from any point in time within the period covered by the accounts.'

639 Peloubet (p203-204), 'In the not very distant past, when accounts were first being subjected to really thoughtful analysis, there was a widespread opinion, which is still held in some responsible quarters, that the balance-sheet was "static" and the income account was "dynamic". In other words, the balance-sheet was thought to be an instantaneous photograph of a business at a particular moment of time, and
economic changes were 'so slow as to be almost imperceptible'. However, a reporting of rapid changes was an anathema for those used to conventional accounting. Instead, arguing for conventional accounting, a balance sheet was more 'a narrative of investment' of contributions by various stakeholders.°

At the other extreme, a broad interpretation of accounting may be found. Henderson and Peirson (2000, p934) raise various tensions met by the interaction between a need for greater corporate social responsibility and how entities account for and disclose socially responsible activities and performances. Disclosures tend to take a narrative form, including monetary and non-monetary data.°

Certainly the ideas from many disciplines are intermingled. Informed decisions using the interrelated ideas in Figure 6.5 like effectiveness and efficiency, integrate ideas from the many disciplines (Enthoven, 1976). Elsewhere, Enthoven (1985, p8-26) categorised various trends, incorporating a wide-ranging series of issues,

- Trend 1 – Accountancy Integration°
- Trend 2: Mega Accountancy Identification, Measurement and Reporting of Relevant Information°
- Trend 3: Efficiency and Productivity Measurements°

the income account was constructed as a sort of symbolic, arithmetical narrative of the happenings in the business between two of the "static" points. This concept, I think, is fundamentally false. It has a certain superficial appearance of truth, because it could have been true in a world where economic changes were so slow as to be almost imperceptible. However, we are well aware that we are not living in such a period in the world's history. Economic changes are rapid and devastating. This, I think, shows the falsity of the "instantaneous photograph" assumption. What then is the truth? As I see it, the balance-sheet is a continuous narrative, much as the income account is, except that the narrative is told from a different standpoint and covers the entire life of a corporation from its inception to the date of the accounts. The balance-sheet is a narrative of investment… It … indicates how much capital was contributed, who contributed it and the rights to and participation in capital of stockholders, bond-holders and various other creditors.

° Peloubet (p208) concluded, 'While the accountant can not make valuations, it is true that he has experience, which puts him in the position of a particularly well-informed layman, so far as engineering, economic and legal facts are concerned, makes him a competent critic of such valuations and should enable him to detect anything grossly or substantially inaccurate.'

° Henderson and Peirson (2000, p934) suggest 'Entities could also be required to specify the objectives of their socially responsible activities and the extent to which those activities and the costs incurred in implementing them have achieved the objectives. However, considerable research is needed to determine the feasibility of measuring in dollars the social costs and benefits of and entity's socially responsible activities.' (Similar sentiments have appeared over the years in various editions. In earlier editions, however, reference to 'financial statements' is found).

° Included here were: The Macro Accountancy Function and Requirements; Accountancy for Economic Analysis, Policy and Planning; Project (Feasibility) Studies; National Economic Profitability Measurements; Accountancy for Capital Formation; Directions in Governmental Accounting.

° Included here were: Value-added Information; Accountancy for Price Change Data; Socioeconomic Measurements; Human Resource Information; Projected and Cash Flow Data.

° Included here were: Nature and Need for Efficiency and Productivity; The Measurement of Productivity; The Need for Decision-Making (Management) Accounting.
Enthoven (p8) points out 'Macro accounting' is 'known as economic, national, or even social accounting'.

The type of reporting sought in CO includes financial reporting, but various arguments have developed regarding a tension found between conventional and financial statements over time and currently. Further tensions follow from introduction of economic and social issues within both conventional accounting and financial statements.

However, economic or social position and performance statements are no longer radical suggestions. Work on CFs for these reports is ongoing but needs to be reconciled with that of the financial type, a task for those interested in interdisciplinary study.

6.4.2 Accountability and accounting

The lengthy history of 'accounting' and the concept of accountability was introduced in Chapter 2. Two ideas emerged - one of a narrow stewardship of the return simply of the original stake. Here, the report would simply state the 'position' of the stake, perhaps where it was placed and its eventual return. In the second, a broader stewardship is required. Being accountable for both the original 'stake' and use made of the original 'stake', the accounting includes the original position statement, another at the end of a given period of time and from these two statements, a change in position statement over that period is deduced, a performance statement. Depending on whether an accrual or a cash approach is taken in the development of the position statement, the performance statement will be of a profit/loss or of a cash surplus/deficit type.

The situation, especially in an adaptive business environment, becomes, as argued in the previous sub-section, most complex. Reasons for this complexity are many and varied. Within potential models of CO, the various stakeholders - directors, other management, shareholders, debt providers, labour, customers, government members and the like - are incorporated. A chain of relationships among these groups and the need to monitor potential tensions among those parties arguably was a reason for the 'accounting'.

Chambers in CoCoA was quite aware of like developments as shown in part by the title of his main work (1966a): 'economic behaviour' was narrowed down to 'evaluation' which in turn was narrowed down to a particular 'accounting'. This is consistent with the title of his earlier text 'Accounting and Action'. Accounting was certainly not simply to produce reports to be read by another accountant. His system

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645 While Enthoven mainly uses the term 'accountancy' in his monograph, he occasionally lapses into 'accounting'. The two terms are regarded as being synonymous for purposes of this study.


647 Gell-Mann (p9) for instance, suggests his research on CASs, using the modern interpretation of quantum mechanics, sees steady progress being made via interdisciplinary study at his Santa Fe Institute.
was consistent with stewardship in the broader sense and the decision-useful criterion met in Chapter 5 and returned to in Chapter 7.

**6.5 Summary and conclusions**

In this Chapter, a context within which CoCoA was developed has been described. It included a series of corporate collapses/failures which interacted with accounting, leading to a continuation of a series of tensions. The context also included a series of mergers/takeovers which interacted with accounting, leading to tensions among selected constituents.

_Argument_

6.11 _The accountability of directors/management to other stakeholders was questioned._

6.12 _ Debate on the meaning of a qualitative standard like the phrase ‘true and fair view’ continued._

6.13 _The technical interpretation of a qualitative standard was promoted by some accountants._

_Argument_

6.21 _The role of accounting reports in any accountability of directors was questioned._

6.22 _The use of dated figures in accounting reports with the potential to mislead investors was questioned._

6.23 _The need for stakeholders to receive contemporary financial data in reports if to be used in decision-making._

The period saw continued tensions on conventional accounting reports. A series of _institutional_ tensions also continued. A move by the Australian profession away from reliance on UK thought and practice began in the 1950s. This was partly from expediency as well as the growing dominance of USA interests via both commercial and accounting firms in Australia (Parker, 1982).

648 The mingling of conventional accounting, financial, economic and social ideas is evident in the CF project where there is reference to economic benefits and costs in economic decisions for the allocation of resources. This results in a misconception of the function of these distinct types of information.

_Argument_

6.31 _Whether accounting in principle differed among types of entities (especially between corporations and individuals) was debated._

6.32 _Whether terminology was to differ among types of entities._

6.33 _The variability of GAAP and selected practices in accounting continued to cause concern._

6.34 _How were related principles/standards/rules to be developed?_

6.35 _Who was to develop those principles/standards/rules?_

6.36 _Whether and how contemporary monetary amounts of assets might be incorporated._

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648 Birkett and Walker (1971, p101) argue that this influence began in 1938 with academic input from writers like Fitzgerald (1949). As pointed out earlier, in the 1970s, a convergence with USA approaches was formalised by AARF.
6.37 Whether and how to incorporate changes in these contemporary monetary amounts in determining income.
6.38 Whether and how to incorporate changes in price levels in general in determining income.

Argument
6.41 Whether and how contemporary monetary amounts of liabilities might be incorporated.

In developing CoCoA, Chambers often demonstrated the inconsistencies between *ex post* and *ex ante* valuation. Links to USA interests would also be seen in the development of various CF projects. Analysis thereof is provided in the next chapter.
Chapter 7 Conceptual Framework Projects and Other Diversions

Travel, discourse with professionals and academics around the world, and a perennial interest in the flaws and infelicities of accounting practice, make it plain that over forty years practice and professional doctrine had become more convoluted, less systemic, more questionable, less serviceable, more opportunistic, less orderly. And increasingly the bulk of criticism from within the profession: from academics, from the courts, from governmental inquiries, from investors, creditors, security analysts and others. All of that was entirely predictable. A colleague in the U. S. [Bob Sterling] who thirty years ago had reached the same conclusions as I on the prospect of our up-to-date and realistic accounting has had all the same kinds of experiences as I — popularity as a lecturer to students, academics and professionals but rejection of the thrust of our main interest in the advancement and reconstruction of practice.

Chambers, (2000, p325)

7.1 Introduction
In Chapter 1, the conceptual framework (CF) project in Australia was introduced. In Chapters 3 to 5, the need for the disclosure of financial information as part of CG was argued. However, over time that disclosure has been challenged, especially by management with whom the accounting profession had some sympathy. The accounting profession responded with conventional accounting — what was argued earlier to be the product of the May legacy. In turn, the quality of that disclosure was challenged. Time and effort were spent to supplant the input-dominated approach taken in conventional accounting (see Chapter 6) with a more output-oriented approach.

The inability of conventional accounting to meet specified needs (other than by chance) led to various tensions in reporting. Some viewed the function of accounting (and accountants) as being much broader than a narrow record-keeping to ensure a report on a custodial stewardship. Some argued that a report by a steward (or agent) required an interpretation in which custody and the use of the resource — a broader stewardship. Others observed that accounting was to provide financial, economic and social information for decision-making. That being the case, different, though related, CFs would emerge.

However, official principles/standards/rules still were not producing quality accounting information. While the underlying infrastructure is an important part of any governance, information and its quality require a unifying philosophy.

649 Dean (2003, piii) provides a summary, ‘Adding urgency ... is the ... spate of unexpected large corporate collapses and the revealed unserviceable accounting data that have preceded (often very close to) those collapses. This requires an urgent autopic review of the fundamental principles (not simply the “rules”) of accounting. Such a review is unlikely to occur based on the public responses to the current "crisis in accounting". Responses to date have focused on the infrastructure that undergirds specifically the accounting standards setting process and the process of corporate governance generally.’

650 Husband (1954, p4), 'It is not possible to build a satisfactory superstructure, to maintain a strong position in the scheme of things, nor to meet in full and reasonable manner the challenge to expand our frontiers without basically unifying philosophy and through understanding of this philosophy. What we do must rest upon a sound basis and must proceed with knowledge of that basis.'
Recall from Chapter 1 that Gell-Mann (1994) pointed out that at some point of
development of a new system, researchers would see paradoxes in either

a) the present established theory, or
b) the ways things were done.

Chambers certainly questioned the then conventional wisdom, leading eventually to
the development and later refinement of CoCoA.\(^{651}\) Why was CoCoA not seen
(perhaps in part)\(^{652}\) the answer?

Changes in and from conventional accounting continue. The rate of change has been slow, as the history of CF projects reveals. Indeed, the premature obituary of conventional accounting appears regularly. The structure of this chapter is built around the CF projects which began in the early 1970s. First, Chambers’ role in early work on that project in Australia is analysed (7.2). It is shown that Chambers had direct and indirect (via his writings) influences on the development of that CF. The CF in Australia is reviewed within the context of issues and propositions identified in Chapter 1. This is followed by an analysis of similar work carried out at the international level. Next, social accounting is examined (7.3). Finally, a summary is provided (7.4).

7.2 The Conceptual Framework Projects of the 1970s et seq

As pointed out in Chapter 6, work began in the USA in the late 1960s which sought to change the then input-dominated approach. An early work was that of the Trueblood Committee (1973). In 1971, Chambers (Chambers & Dean, 1986, p341-349) submitted to the AICPA a response. This was the basis for a later publication (Chambers, 1974a). The FASB’s Discussion Memorandum (1976) followed. In 1976, Chambers refined his ‘Objectives’ paper which provided a basis for several works (including Chambers, 1976a). Complementary works on CF projects were to follow in other countries. In the Anglo-American sector, these included Stamp (1980) in Canada\(^{653}\) and Macve (1981) in the UK. Stamp (1982) commented on both the USA and the UK works.

Key contributions from the USA included (see 6.2.1) APB Statement No. 4 (1970). Henderson and Peirson (1988, p 4) note this became the USA profession’s CF until in 1973 the APB was replaced by the FASB (Litke, 1973; 1974). The latter was to be

\(^{651}\) In an analysis of that theory and its development (ranging from say the late 1940s through ‘Blueprint ... ’ in the 1950s and ‘AE&E’ in the 1960s to ‘An Accounting Thesaurus’ in the 1990s), one cannot be anything but intrigued by the wide ranging nature of his readings and the references used as support for that theory.

\(^{652}\) Perhaps this is already occurring as standard-setters propose measuring selected assets and liabilities at exit price (often as a proxy for fair value) as part of the movement away from historical cost. In Australia, Miller (2000, p2) and Miller & Loftus (2000, p7) refer to the astonishing extent of the ‘current value creep’, including exit price methods. This is further discussed in Chapters 8 & 9. In USA, FASB (2004) distributed a ‘Fair Value Measurement’ Exposure Draft. This was followed by FASB (2006, January) Proposed Statement of Financial of Financial Accounting Standards ‘The Fair Value Option for Financial Assets and Financial Liabilities’.

\(^{653}\) Parker (1982, p429) comments, ‘Note that Stamp’s points are mainly political and social rather than economic and commercial.’
formally independent of the accounting profession as a new standard setting body. Work commenced immediately on the development of a conceptual framework.\textsuperscript{654}

Some like Most (1984, p30) remained critical of the accounting standard-setting bodies being dominated by financial accountants who, like early accounting textbook writers, displayed either ignorance or disregard of cost accounting.\textsuperscript{655} He analysed the move from the CAP to APB to FASB to highlight the composition of the various bodies. That of the first showed such domination. That of the APB, while too so dominated, did include representatives of industry, government, and academe. Indeed, Most concluded that in these early years of the APB’s standard-setting process, a managerial viewpoint tended to dominate. The relatively small seven member board of the FASB maintains the domination by financial accountants without much breadth of representation. He used an analysis of selected statements to conclude a lack of inclusion of cost accounting and by implication management issues.\textsuperscript{656}

The CF project in the USA proceeded slowly, therefore drawing criticism (Miller & Redding, 1988, p108). At one stage it was thought the FASB may abandon the project as Miller (1990) claimed. Arguably, the SEC would view this as a serious failure, so FASB continued with the project. A need to revisit (FASAC, 2004a, p6-7) was based on,

- most of the CF being developed twenty or more years ago,
- CF not keeping up with changing times and business practices,
- consistencies within the CF needing to be eliminated,
- selected planned work not being completed, and
- a move towards ‘principles-based’ accounting standards.

However, in Australia, the period 1976 – 1983 was one in which various issues of CFs were debated. Chambers and his writings provided major inputs.

7.2.1 Insights from The Collection

In 1976, Chambers was a member of the Joint Standing Committee (JSC) which comprised the Executive Committees of the two professional accounting bodies in Australia. The JSC was the body to which the Australian Accounting Research Foundation (AARF) was accountable. AARF comprised an Administrative Committee, an Accounting Standards Board (AcSB), an Auditing Standards Board, a Legislative Review Committee and a Taxation Committee. (See AARF Constitution, USA P202, Box 82, #11239).

In 1981, Chambers accepted the invitation (#11239) to be a member of the AcSB, his term being until December 1983. He would therefore receive various materials from

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\textsuperscript{654} Nobes and Parker (1986, p 23) noted ‘the need for a conceptual framework was one of the primary considerations in the studies that led to the establishment of the FASB.’

\textsuperscript{655} See Johnson & Kaplan (1987) and Murray (1989).

\textsuperscript{656} Most (1984, p31) found ‘the entire thrust of the FASB’s standards on accounting for changing prices ignores the sophisticated responses to this problem developed by management accountants over the past half century.’ As well, many of those had been developed in European, non-Anglo-Saxon countries.
the AARF. The AcSB was chaired by R G Lee, Senior Partner, Price Waterhouse & Co. Many varied issues were canvassed, ranging from whether an Australian version of the FASB CF was required through who should develop the framework to more technical matters like those of measurement. The technical staff of the AARF researching the issues of an Australian CF included K M Stevenson.

In August (USA P202, Box 82, # 11240), Stevenson prepared two papers (1981 and 1981a). The first included the structure of the AARF (as per the Constitution referred to above). At that stage, of the technical staff of six, four were working on AcSB matters, one on Audit matters and one on the matters of the other committees. This weighting may be seen as indicative of emphasis in AARF on AcSB matters. A reference is made (Stevenson, 1981, p7) to work being carried out by the FASB in the context of currency translation and reporting.657

Criticisms should of course be seen in the context of that time. Fluctuations in income were to be avoided (earlier times referred to as ‘income smoothing’, but today referred to as ‘earnings management’), data reported depending on what was seen as ‘economic reality’. Reporting of foreign subsidiaries and hedges were topical issues.

Stevenson (1981a) made much use of Chambers’ writings, including exchanges between Gerboth (1972 and 1973) and Chambers (1973a). From this exchange, Stevenson adopted the argument of a distinction between the taking of

- an incremental approach, and
- a comprehensive one.

Gerboth suggested the former, Chambers the latter.658

Stevenson argued (p7), ‘The only choice open to an involved standard-setter is between strategies leading to varying degrees of comprehensiveness.’ However, he did accept Chambers (1973a, p49) argument as to the

four aspects of advancing accounting practice:

1. discussing what is wrong or defective in present practice;
2. knowing (or discovering) how things or actions are related to one another, and how symbols of things are related to thinking and acting;
3. devising rules which will lead to symbols which are useful or fruitful in the process of thinking about financial matters; and
4. convincing others that the rules are efficacious or imposing those rules on others.

657 Stevenson (1981, p7), ‘More specifically, the U.S. standard was criticised for causing sizeable but meaningless fluctuations in income, for generating data that did not gel with economic reality, for upsetting financial relationships in the accounts of foreign operations upon translation and for ignoring effective hedge situations.’

658 Stevenson continued (p3), ‘It would be even more superficial to suggest that Chambers was vindicated in his views by the mounting of the conceptual framework project by the FASB.’
Stevenson saw difficulties and limitations arising. At issue here was whether bureaucratic tendencies, along with the pressures of dealing with ‘today’s problem’, would produce logically consistent standards, perhaps only by chance. Stevenson argued for the continued use of conventional accounting (with the May claim to ‘educate’ users of limitations) rather than a new model.

This approach was not that of Chambers who sought a comprehensive change, including the adoption of CoCoA. Perhaps not surprisingly, Stevenson (p8), to support his approach, turned to Chambers (1979a), arguing, ‘… Chambers has acknowledged that a less than perfect approach is in order, as long as it is one of “trial and error-elimination” and not “trial and error-accretion”.’

Stevenson (p8) concluded, ‘What I am suggesting is tantamount to the first two aspects of advancing accounting practice suggested by Chambers.’ Change would be gradual rather than a major revolution. Chambers’ Copernican Revolution (1966a, p373-376) and the Kuhn-related consequences Chambers saw necessary would not be the preferred approach in the Australian CF project.

While arguably the status quo of conventional accounting was to continue, Stevenson (p8) did caution,

*Incidentally, I think that an explicit strategy which should be adopted is one of learning as much as possible from the American experience. This would include serious investigation of the types of criticism outlined previously in respect of the FASB’s work on objectives. As is often said, unless we learn from history, we are doomed to repeat its mistakes.*

Of course, Chambers (1980a) and others (for example, Clarke et al, 1997, 2003) would argue that accounting standard setting at best looked at the wrong ‘history’ or at worst, did not learn at all from history.

Members of the AcSB were sent (USA P202, Box 82, #11234) a paper by Greenwood (1981), a member of the National Companies and Securities Commission (NCSC). Covered were issues met in Stevenson above, as well as new ones. Greenwood (p13) raised the issue of the role of the profession in the development of the framework.

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659 Stevenson (p7-8), ‘… that the accounting profession in Australia runs a serious risk of failure in its attempts to devise meaningful accounting standards if it continues to be preoccupied with institutional, procedural and ad hoc topical considerations. Those aspects have their place, but are not of paramount importance.’

660 Stevenson (p8), ‘Another limitation in design would be, at this stage, to avoid the attitude that the framework would, or should, justify selection of a particular accounting model. Somewhat pragmatically … I would “place the peg”, for the time being, in the “conventional accounting hole” and aim at becoming more attuned to the characteristics, both good and bad, of today’s accounting practices and theory. This is not to say that I would be seeking to make conventional accounting completely viable or to justify it. The aim would simply be to educate the standard-setter before moving on.’

661 Greenwood (p13), ‘For similar reasons the role of the accounting profession in promulgating the content of disclosure must be limited to that of expert consultant rather than determining body: the accounting profession is not an impartial onlooker in prescription of disclosure, since firstly the practice of public accounting is a business enterprise and must be run as such, and the accountants’ client contacts are primarily the producers, not the users, of the end product; secondly, there is the subtle interest that every profession has in preserving and enlarging the field of its own endeavour.’
Questioned here was the potential conflict of interest the accounting profession faced in their control of the development of accounting standards. As shown in Chapters 4 to 6, this issue had been well aired (though not resolved) in USA. This was especially so in the times of the New Deal of the 1930s.

Macve (1981, p11) too discussed ‘conflicts of interest’.662 The argument has similarities with that between Berle and May met in Chapter 4. The profession would ensure it played a major role in any CF. Greenwood (p13-14) introduced potential objections from management, including the usual arguments against legislation in general and disclosure in particular.663 Cost-benefit, later to appear in SAC 3 (AARF, 1990b), was discussed.664

The idea of an Accounting Standards Review Board (ASRB) was floated. Its tasks were to

- approve priorities proposed by the profession,
- review standards regarding community acceptability, and
- refer standards to the NCSC for endorsement and legal sanction.

At a technical level, Greenwood (p23-25) raised issues of measurement in general and for various models in particular. Tensions here are further discussed in Chapter 8.

Stevenson circulated various writings, including the Carscallen Report (1981) from Canada. He also included a paper, obviously built on the Carscallen Report (for instance Recommendation 5: General principles vs. detailed rules and Recommendation 6: A conceptual framework vs. pragmatic standards may be directly linked), which included a series of ‘questions’ for consideration by the members of AcSB (USA P202, Box 82, #11234).

Questions Stevenson asked included Q2 dealing with the different levels to be met for reporting requirements of legislative concern as well as the role of accounting standards. Q3 on criteria to judge accounting standards saw suggested

1. ‘generally accepted’,
2. logically consistent and consistent with other standards, and
3. generally in accord with economic reality.

Q6 on political-suasion and ‘objective structures and process’ were to include public comment on conceptual matters generally and the models for CCA and CoCoA in particular. Arguably, recycling of issues (met in Chapter 4) continued.

Building on his work on CoCoA, Chambers, in a letter to Lee (USA P202, Box 82, #11235, cc to Stevenson), suggested that a conceptual framework could be built

662 Macve (1981, p11) concluded, ‘These problems make accounting and the establishment of a conceptual framework a “political” as well as a “technical” matter.’

663 These included threats from competitors, undue costs and possible lawsuits.

664 Greenwood (1981, p14), ‘Of course financial information is not a free good (even though it may appear to be so to some users). It therefore ought not to be required to be produced unless its production yields appropriate benefits.’
around 10 general principles and 3 definitions. His 13 points are reproduced in Appendix III. (The three definitions would be 8. Financial Position, 10. Net Wealth or Equity and 11. Income.)

Minutes of the first meeting of the AcSB (#11242) recorded discussion of the need for a CF. Papers from Chambers (1971) and Barton (1971) were distributed for perusal and discussion at the next meeting. Minutes of the third meeting (#11242) recorded discussion took place of Chambers’ CF.

Chambers’ CF would be overtaken by other events. In a memorandum to the group from Stevenson (1982) was included (p8) the diagram – Version 1 of the CF. He earlier had written of the importance, ‘from a design viewpoint, (of) acknowledging the Framework as being pyramidal, with a statement of objectives at the apex.’ This is reproduced in Appendix I and certainly identified clearly the various levels of abstraction involved. It was included in the Joint Submission to NCSC (USA P202, Box 82, #11234) in Schedule E Notes on the Origin of a CF.

An analysis of Version 1, Chambers’ paper (1971) and his CF is provided in Figure 7.1. Similarities and key differences are shown. Debate is to be expected as other researchers may classify issues/ideas in a different manner, as especially particular terms and phrases may be interpreted differently. Any analysis also covers many issues implicitly.

Major differences are Chambers’ exclusion of future events/transactions and their consequences for the financial statements. While decision-makers may require data of an ex ante type, these were to be excluded in the financial statements under CoCoA. This is made quite clear in Points 10 and 11 of Chambers’ (1971) submission to the FASB which in turn was made available to members of the AcSB. While it is possible to infer that Chambers had little explicit effect as a member of the AcSB, a stronger inference would be that Chambers’ writings had a major implicit influence on individual thinking and the final output.

7.2.2 The Australian CF
The early work of the AASC of the AARF met stiff criticism (recall 6.2.3). As a result the profession decided to re-organise the standard setting procedures. It established in 1981, within AARF, the Accounting Standards Board (AcSB) and subsequently the Public Sector Accounting Standards Board (PSASB) and the Auditing Standards Board (AuSB).

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655 Minutes of the second meeting (10 February, 1982, #11242) recorded, ‘The papers received from Professor Chambers were not discussed in detail. It was agreed that the staff should provide a summary of all papers distributed which the Board could discuss and thus assist the Board in monitoring its own decisions in a matter that, over time, allowed the development of a consistent and purposeful approach to preparing standards.’

666 Minutes of the third meeting (17 March, 1982, #11242), ‘The paper titled “A Conceptual Framework” by Prof. Chambers ... was tabled. Professor Chambers spoke on the paper, explaining the 11 general considerations or principles set down therein and then briefly outlining 3 key definitions provided. The Chairman thanked Professor Chambers for his paper and invited members to consider the paper outside the meeting for discussion at a later stage, or as applicable on particular projects.’
Certainly **institutional** results were seen as improvements on those from earlier eras. However, significant progress in the quality of accounting data was still seen to be lacking. Corporations like Mineral Securities, Cambridge Credit, Mainline, Gollin Holdings and Associated Securities (ASRC, 1978; Clarke *et al.*, 1997, 2003; Sykes, 1988; Henderson, 1993, p9) in the 1970s still *unexpectedly* failed in circumstances that caused criticism (similar to that of the 1960s) to be levelled at the profession and its accounting standards. While the standard setting **institutional** processes had been refined, something was still perceived to be wrong with the basics of the standards themselves and the *quality* of related *information*, especially for decision-making.667

**Figure 7.1 Comparison of Version 1 and Chambers’ CF**

<table>
<thead>
<tr>
<th>Version 1 Block</th>
<th>Similarities</th>
<th>Chambers’ CF Differences</th>
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<tbody>
<tr>
<td>2 Information</td>
<td>1. Utility</td>
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<tr>
<td>3.A Definitions</td>
<td></td>
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<tr>
<td>Characteristics</td>
<td>5. Periodicity</td>
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<tr>
<td>Relevance</td>
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<td>Reliability</td>
<td>2. Arithmetical Propriety</td>
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<td>Comparability</td>
<td>13. Verifiability</td>
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<td></td>
<td>3. Historicity</td>
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<td>7. Uniformity</td>
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<td>4.A Recognition</td>
<td>6. Completeness</td>
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<td>Transactions/Events</td>
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<td></td>
<td>10. Net wealth or Equity</td>
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<td>5.B Performance</td>
<td>11. Income</td>
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<tr>
<td>5.C Financing &amp;</td>
<td>1. Utility</td>
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<td>5.D Liquidity &amp;</td>
<td>1. Utility</td>
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<tr>
<td>Solvency</td>
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</table>

667 Merino (2003, p285), 'The fact that a disclosure of accounting policies in annual reports was not required until the 1960s further suggests that providing information for decision making was not a primary goal of the regulators.'
Arguably, the post-1960s era in which many accounting standards were developed and issued did not address the roots of the criticisms of financial reporting. The reaction to the unexpected company collapses was to some extent rather tepid. The quality of resulting statements was still of concern. Much time and effort was spent on the inflation issue. The era did spawn (and perhaps overlap to some extent) the search for a CF for financial reporting.

A catalyst for the CF project in Australia was government intervention as a result of impatience with the profession. Following an extended period of criticism of the accounting profession for its apparent failure to produce and enforce accounting standards (AAS), recommendations to the Ministerial Council for Companies and Securities by the NCSC saw in January, 1984, the establishment of the Accounting Standards Review Board (ASRB). The ASRB’s powers included a requirement to specify a conceptual framework (Henderson and Peirson, 1988, p 163; Henderson, 1993, p8).

The ASRB was to approve standards submitted to it by AARF or others, so giving them legislative backing. Consequently two sets of standards emerged: AARF’s professional standards and the ASRB approved standards. The accounting profession called for a merger of AcSB and the ASRB to rationalise the standard setting process, which eventually occurred in 1988.

The ASRB (1985) issued Release 100 (about the same time as Sutcliffe, 1985) which set out criteria for evaluating proposed AAS and also tentative assumptions which proposed standards must satisfy. Under the AARF work on a CF project, Sutcliffe had developed a CF model for the PSASB which incorporated the CF diagram (recall Stevenson earlier and Appendix 1). This diagram subsequently formed the basis of the Australian CF project, after being revised and enhanced in 1987 (Appendix II).

The CF project included Statements of Accounting Concepts (AARF, 1995). Related AAS were developed to guide stakeholders with an interest in external financial reporting. The perceived benefits included

- outcomes more consistent and logical than those previously,
- increased international harmonisation, and
- more accountable standard setting bodies.

The CF entails levels of abstraction and a series of building blocks into which the development of the framework could be divided. Various Levels/Blocks were to be

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668 For example, Clarke et al (2003, Chapter 6) commented on the lack of action by the profession.

669 Debates and selected criticisms are found in Chambers’ writings, for example Chambers (1965b, 1966b, 1967a, 1967b).
elaborated upon in SACs. These would provide the reasoning underlying particular AAS\textsuperscript{670} and be consistent with the work within the FASB.

Intriguingly, the first level of the CF project – Scope – has not been the subject of a SAC in its own right. This block requires a definition of financial reporting. Usually this is implicitly considered in the context of general purpose financial reporting which was certainly much broader than Chambers’ financial statements.

Perhaps a SAC here opens a Pandora’s Box of accounting. For instance, Henderson and Peirson (2000, p32) write of the difficulties of incorporating performance indicators in ‘financial reporting’, especially efficiency indicators which are non-financial (employee turnover) or partly financial ($ sales per employee). Another difficulty is how to incorporate future-oriented financial data. (These issues have been included in the authors’ various editions over the years since the 1980s). Obviously, other disciplines were influencing the reports of an accounting.

Blocks 9, 10 and 11 of the CF (found at the Display level) are respectively titled ‘Financial position’, ‘Performance’ and ‘Changes in financial position’. The first includes reference to
- wealth
- financial structure
- capacity to adapt
- solvency/liquidity.

The second includes reference to
- change in wealth/consumption of resources and
- variability.

The third includes reference to
- financing activities
- investing activities.

Actual discussion of these ideas in official pronouncements is limited.\textsuperscript{672} Display would include an identification of information categories and the analysis of the

\textsuperscript{670} As part of the stated aim of providing guidance for more consistent and logical standards, to date Levels 2, 3, 4 and 5 in part (Blocks 2 - 6 inclusive) have been the subject of SAC1 to SAC4 respectively. Level I/Block I, ‘Definition of financial reporting’, has yet to be the subject of a SAC.

\textsuperscript{671} Burton (1981, p54) would agree as he argued, ‘One of the most significant changes in financial reporting is the steady erosion of the relative importance of financial statements. At one time, financial statements were the whole of financial reporting. Over the past decade, however, more financial reporting innovation has taken place outside the financial statements.’

\textsuperscript{672} Clarke \textit{et al} (2003, p38), ‘Directors of an Australian company are between a “sword and the wall” – “a rock and a hard place”. Under the Corporations Act they are required to ensure that the published profit and loss account and balance sheet comply with the AAS and AASB Accounting Standards and portray a true and fair view of their company’s results for the period and its state of affairs. They also have to give a “solvency statement” – whether the company is (in their opinion) able to pay its debts as they fall due. Even so, this is a confusing setting, for under the Corporations Act a company has to keep such accounts and records as will “explain its transactions ... and financial position”. Nowhere is it explained what the difference is between the “state of affairs” on which the directors have to report and the “financial position” which has to be explicable by the accounting records.’
various components, thus providing a logical basis for particular disclosures required under particular AAS (both existing and potential).

Revenue and expense are defined in terms of the basic concepts found in the Statement of Financial Position - assets and liabilities, with particular reference to the exclusion of changes to the residual equity which represents that of 'owners' as defined (AARF, 1992). As pointed out earlier, this represented a major change in emphasis in the thinking of those concerned with financial reporting and the related standards. In the context of the reporting of performance, it highlighted the change from an input fixation (the May legacy) to a more output based orientation.

The project, being built on the various 'levels', provides a logical structure for debate of various issues. The CF may be most fruitful in resolving debates by at least ensuring they are at the same level.673

AARF (1995, plvi) incorporated Sutcliffe's revised diagram and deleted the assumptions which were effectively replaced by the now developed SACs. The first three SACs were greeted with general apathy by the business community (Henderson, 1996, p377).674 However, in November 1990, compliance with SACs became mandatory for members of the professional bodies. The issue of SAC 4 (after a lengthy period which included a series of exposure drafts)675 received a hostile reaction from some practising accountants and the business community.676

Interestingly, this event saw the emergence of the Group of 100 as an effective lobby group for big business, especially regarding accounting tensions.677 This group would

673 However, interest in issues of 'liabilities' can lead to most frustrating discussion. Debates on the definition of liabilities (Block 5) may become impossible to resolve with academic colleagues as it may get bogged down as the issue to debate would move to Block 1 or 3, while fellow practitioners, more concerned with Block 9, would move the argument to that level.

674 Henderson (1993, p11), 'It is reasonable to suggest that the idea of a conceptual framework, the issue of exposure drafts and the first three [SACs] created little interest in the profession on (sic) the business community. The whole programme was seen as "academic" and of little interest to the world of affairs.'

675 Henderson (1993, p13), 'Although most of the criticism for the SAC4 episode has been directed at the standard setters (including some vicious personal attacks) it is clear that the fault for the debacle lies mainly with the business community and the practicing members of the accounting profession who failed to participate in the due process preceding the issue of SAC4. The standard setters did not conceal their intentions.'

676 Henderson (1993, p12), 'The reaction to SAC4 by some accountants and the business community was immediate and hostile. SAC4 was condemned as academic (the ultimate criticism), radical, leading the world (a heinous crime) and as evidence of a plot by the standard setters to supplement historical cost with some new unspecified system. This reaction to SAC4 was not expected.'

677 Henderson (1993, p13), 'The absence of such an organisation in the 1970s and 1980s was a major reason why the business community was unable to stop the issue of some standards. The Group of 100 may now be expected to play a major role in scrutinising accounting exposure drafts and commenting on financial accounting issues. The standard setters will have to cope with a powerful conservative counter-vailing force which will make it harder for them to make any significant changes to financial accounting.'
oppose departures from conventional accounting (Henderson, 1993, p15), tolerating changes seen as radical provided they were non-compulsory (Henderson, 1996, p15). Not having the force of an approved AAS, SACs remained appropriate for preparers, auditors and other members of the profession to consider in their particular functions.

Criticism of the quality of accounting information was muted, despite another series of corporate collapses in the late 1980s-early 1990s. Henderson (1993, p9-11) argues there were two major differences from earlier times:

- little criticism of accounting as such, and
- the CF project.

This time, human error (by management, accountants or auditors) was blamed rather than system failure (Henderson, 1993, p10-11). Calls for improved personal qualities were a recycling of the arguments of Roosevelt (Chapter 2) and May (Chapter 4), but Chambers (1991a) would challenge this suggestion. Further, academics in the main were now missing from debates on quality of information. Interestingly, the exception notable to Henderson (1993, p10) was the work of Clarke & Dean (1992), both colleagues of Chambers.

The second difference above was the existence of the CF. To some extent, it did provide a basis for consistent standards. In 1991, the statute was amended to make compliance with approved accounting standards compulsory (Henderson, 1993, p14). An implication drawn from this compulsion using a black letter approach was the involvement of those in the legal profession (p15). In some ways, this increased involvement of lawyers is a return to the control of corporations (met in Chapter 2) by the requirement of ‘true and fair’ reports. Lawyers will debate what is actually written in the standard.

Debate on the information to be presented and its quality would continue, but at a slower pace.678 However, changes of an Institutional type continued. On January 1, 1991, the Australian Securities Commission (ASC) was formed to administer the now national Corporations Law. Further entrenching a national approach, it replaced the NCSC and the various corporate affairs offices found in particular states and territories. New consumer protection responsibilities were added to the duties of ASC from July 1998 when its name was changed to the Australian Securities and Investments Commission (ASIC). In July 2001, new federal statutes replaced old laws mainly to reflect the constitutional underpinnings of the new truly Federal legislation.679

The ASRB was replaced by the Australian Accounting Standards Board (AASB) in 1991 under the Australian Securities Commission Act (Section 226 (1)). A CF continued to be sought to evaluate proposed accounting standards. While the players had new names, more resources and more elevated legal status, essentially the

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678 Henderson (1993, p17) concluded, ‘T]he rapid changes in financial accounting and reporting during the period 1970-1990 will not continue into the 1990s. In the last decade of the Twentieth Century, financial accounting will remain much more stable than in the preceding twenty years.’

679 The new acts were the Corporations Act 2001 and the Australian Securities and Investments Commission Act 2001.
functions had remained the same. Development of a CF remained firmly entrenched as one of the powers and priorities of the AASB.

The Peirson Report (1990) proposed institutional changes and did not affect the thrust of the CF. In response to these proposals, Rahman (1991) argued for more user participation. Others argued that the CF would see changes in actual accounting standards (English, 1988; Henderson and Goodwin, 1990). Indeed, various AASBs of the 1990s were built around that CF and were certainly ground-breaking in the advance of non-historical cost methods for the measurement of particular assets and liabilities. These will be further discussed in Chapter 8.

Further institutional changes were proposed (Peirson, 1990; 1990a, p14). These included

- the formation of two broadly-constituted consultative groups (one for the private sector and the other for the public sector),
- the establishment of a Foundation independent of the profession, business and the government (with funds to be provided from a broad group of sponsors), and
- the establishment of a single independent standard setting body by 1995.

In 1994, mirroring overseas moves, the Urgent Issues Group (UIG) was established to reach some consensus on particular accounting issues which received divergent treatments as authoritative guidance was lacking. It would become a committee of the AASB.

However, debate continued among the accountants’ group, the business group (primarily the stakeholder ‘management’) and the Federal government as to the future of Australian accounting standards (Walters, 2001). It was argued accountants still dominated the standard setting process. Management of the large global entities argued that Australian standards differed from international standards. Some accountants in turn argued that Australian ones were of better quality than the international ones. Some aligned with small entities argued that the standards were of little use for these bodies. In due course, the Federal Government introduced in 1997 a Corporate Law Economic Reform Program (CLERP). This took the form of a series of policy papers or statements issued for interested stakeholder comments. After due process, reforms were proposed and in time AAS would be given legal backing.

680 Rahman (1991) also provided a brief history of standard setting in Australia, suggesting four phases. These were from 1946-1970 during a time he termed ‘professional guidance’; from 1970-1984 that he termed ‘professional self-regulation’; from 1984-1995 that he termed ‘mandatory accounting standards’ and from 1995-onwards that he termed ‘independent standard setting’. He did not identify any catalysts or events leading to any changes between phases. Certainly, as shown in Chapters 2 to 6, other phases may be used.

681 At the time of the completion of this thesis moves were afoot to disband the UIG.

682 In USA, Previts et al, (2003, p148) point out that as regards the work of the chief accountant of the SEC, each ‘was affected by specific economic and political events which shaped the marketplace.’ These included two topics of interest to this study: the quality of global financial reporting and the process by which related standards are established. As might be expected, the CF project was emphasised (Previts et al, p156-157).
In 1999, the Financial Reporting Council (FRC) was established and given the responsibility for oversight of the accounting standard-setting process for entities in the private, public and not-for-profit sectors. Legislative provisions expressly limit the involvement of the FRC in the work of AASB as a way of ensuring independence. A change implemented in 2000 as a result of the CLERP saw the restructuring of the activities of AARF to centre on two boards— the Auditing & Assurance Standards Board (AuASB) and the Legislation Review Board (LRB).

That basically remains the case today as regards institutional tensions; but what of information tensions? These again arose when debate on ‘true and fair’ was revisited.

7.2.3 True and fair view revisited
Kohler (1991, p56) commented (within the context of a well-publicised, unexpected collapse— Spedley Securities) on debates on financial statements and their audit.683 Waldron (Cohn, 1991, p20) made the defensive, professional practitioner response that corporate collapses were not caused by errors in the audit. Kohler suggested that this simply perpetuated a furphy, arguing the wrong point (or at distinct levels of abstraction). No case could be made that auditors had caused ‘the rash of corporate collapses in Australia over the past few years.’ Instead, Kohler argued for better accounting standards which in turn would lead to better quality information.684

This argument is consistent with that found in earlier Chapters where one ‘control’ on companies (especially public ones) was the requirement to provide useful or serviceable financial statements. Another was to have these statements audited by some external entity. Both the directors/management and the auditor were to meet the ‘true and fair’ qualitative standard.

Citing Chambers (1991a), Kohler restated the case that accounting was not an ethical or moral issue but simply a skilled task derived from law, arithmetic and factual reporting. Under CoCoA, assets were to be shown at ‘true values (i.e., selling values)’ rather than the values calculated under conventional accounting. Interestingly, little reference is made to liabilities.

Kohler lamented the suggested removal of ‘true and fair’ from statutes.685 He preferred the phrase to over-ride if necessary AASB. He did argue that ‘debts owed’ — a

683 West (2003, p41), ‘Rather than responding to the preferences of consumers or the directives of external agencies, the nature of professional services is determined in substance by professionals themselves. This is not to imply that professional work necessarily proceeds in an undisciplined manner according to the whims of individual practitioners. On the contrary, a cognitive oversight is presumed to operate, with the bounds of acceptable technical practice defined by the knowledge base of the profession. It is on this ground that responsibility for ensuring the serviceability and quality of professional services is turned over to the providers of those services.

684 Kohler (1991, p56), ‘Auditors and accounting standards are under attack for a failure to properly inform shareholders and creditors about the problems: it is not an auditor’s job to prevent a company getting into trouble — it is his or her job to make sure everybody knows that it is in trouble.’

685 Instead, ‘financial statements are to comply with accounting standards, and that’s all. There has been little argument against this idea, mostly because it merely confirms the disuse into which the phrase has long since fallen. But it still avoids the issue.’ The phrase was not later omitted from the statute.
liability – be included for the statement to be ‘fair’. While brief discussion of ‘control’ as a criterion of recognition within a consolidation context was found, the valuation of liabilities was not raised.

The suggested removal of the phrase from Company Law was supported by McGregor (1992). After a brief outline of the historical development of that concept, he (1992, p68) agreed that the concept of ‘true and fair’ view as found in Australian and UK companies law overrode the more specific financial reporting requirements under law – to comply with legally enforceable accounting standards.

It was argued by some in the profession, including McGregor, that the legal backing of any approved accounting standards meant that financial reporting using those standards provided adequate safeguards for external stakeholders. Arguably for a time, directors had two choices. First they could comply with approved accounting standards, Schedule 7 of the Act and provide additional information to present a true and fair view. Second they might not comply with a standard if they were of the opinion that to do so would not present a true and fair view.

Since ‘true and fair’ had never been authoritatively defined by either the accounting profession or the courts, McGregor (1992, p69) suggested ‘it has often been either misused – in the sense of being used to justify non-compliance with accounting rules – or effectively ignored – in the sense that it has been applied as meaning conformity with the minimum legal requirements.’

Tensions on the meaning of ‘true and fair’ continued. McGregor (1992, p69) used research by Nobes and Parker (1991) to infer that argument would not be resolved for some time. To some, it was a ‘transcendent concept’ that went beyond specific financial reporting rules and thus cannot be limited by them. To others it meant merely complying with specific financial reporting rules. However, tensions remain on which ‘framework’ to follow. Certainly conventional accounting had been found wanting. Not surprisingly, Chambers and Wolnizer (1990) argued CoCoA would be a more appropriate one.

686 As suggested in 6.3.1, a more lengthy historical outline of the concept is found in Wolnizer (1985); Chambers & Wolnizer (1990 & 1991).

687 The debate continues to the present. Clarke et al (2003, p39), ‘Auditors are in an invidious situation as well. They also are to report whether the accounts conform to the Accounting Standards and show a true and fair view of the same matters on which the directors are to report and the accounting records are required to explain. It is a curious arrangement. For, arguably the pre-1992 override that the accounts had to conform to the Standards, subject to them showing a true and fair view, has been removed from the law as a first order imperative. At least many have thought this to be so. Company directors are on a hiding to nothing when it comes to trusting their reputations to the accounting statements for which they are responsible. Recently several leading accountants and lawyers have questioned this downgrading of the override.’ See also Cook (1997); Stacy (1997); Dunk & Kilgore (2000); Alexander & Archer (2003); Evans (2003); Dean (2004, 2005).

688 McGregor (1992, p70) concluded, ‘In fact, the amorphous nature of the concept defies definition in its own right. It only acquires meaning when applied in the context of a specific financial reporting framework. The next step then in the legislative reform process is to specify a financial reporting framework which is more definitive.’
McGregor (1992, p70) thought the accounting profession wise in not employing the concept of “true and fair” in its authoritative literature. This may be seen as part of a defensive approach. The accounting profession was to provide an explicit financial reporting framework to guide a preparer and an auditor. The former can present financial reports in accordance with that framework, while the latter can form an independent opinion on those financial reports within the context of that framework. Note the emphasis on preparers and auditors rather than other stakeholders. The requirement for financial statements to present a true and fair view would be replaced by a requirement to ‘present fairly the financial position and results of operations of the company in accordance with Statements of Accounting Concepts and Accounting Standards’.\(^{689}\)

McGregor (1992, p71) concluded the concept of ‘true and fair’ to be an accounting anachronism in today’s environment. Interestingly, he recalled comments made by Baxt (1968, p309) in analysing the concept of ‘true and fair view’. At that time, when amendments to the then Uniform Companies Act were being discussed, Baxt argued for a statute to lay down the accounting principles under which the financial statements were prepared. These would make the phrase ‘true and fair view’ redundant. McGregor argued that point had been reached.

The reference to Baxt leads to one of those ‘unforeseen consequences’. As pointed out in Chapter 6, at that stage Baxt was a colleague of Chambers. Indeed, as Wolnizer (1985, p147) pointed out, both Baxt (1970) and Chambers (1973a) argued against the technical interpretation. It might easily be inferred that Baxt (and of course Chambers) would see CoCoA as the well-developed framework to see what McGregor would term the demise of the concept. Chambers would prefer to argue, however, that this would see the technical and the popular meanings becoming synonymous.

The lengthy debate (Chapters 4-6) on the use of the phrase ‘balance sheet’ saw the situation officially change in Australia. AASB 1040 ‘Statement of Financial Position’ deals with that statement which is the title to replace the balance sheet. Its stated purposes are to prescribe the:

- bases for the presentation of assets and liabilities,
- bases for the classification of those categories and equity,
- presentation and disclosure requirements.

Regarding the **presentation** of liabilities, the general rule that current liabilities must be presented separately from non-current liabilities remained. However, presentation is to be in liquidity order if this provides more relevant and reliable information than a current/non-current presentation. This could be the case, for example, of a reporting entity operating as a financial institution. A long-term interest-bearing liability to be settled within twelve months is to be classified as non-current if the original term was for more than a year and if the entity is committed to an agreement to refinance.

\(^{689}\) McGregor (1992, p71), ‘Adoption in the legislation of this financial reporting framework will bring it into line with the approach adopted by the accounting profession. It will also be broadly consistent with the approaches followed in Canada and the United States.’

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In cases in which a loan covenant is breached, for the liability to be classified as non-current the lender must agree not to demand repayment, further breaches not probable and the date of repayment being beyond a year. If relatively minor technical breaches of loan covenants occur, which sometimes happened in practice, the long-term debt may not have to be shown as current provided a statement can be obtained from the lender that payment is not demanded. If these minor breaches are ongoing, then the debt covenants need to be redrafted.

When classifying liabilities, consideration is to be given to

- liquidity,
- extent to which security or guarantee is provided,
- expected timing of repayment,
- source, and
- any conditions attached.

Assets and liabilities may only be set-off\(^{690}\) when required by another accounting standard.

In the statement of financial position, classes of recognised liabilities must be separately disclosed:

- payables,
- interest-bearing liabilities,
- tax liabilities, and
- provisions.

Further sub-classification is possible in the statement itself or in accompanying notes.\(^{691}\)

The adoption of IAS in 2005 in Australia saw a reversion to the use of balance sheet and arguably back to the terminology of conventional accounting.

### 7.2.4 The IASB Framework

Following interest shown at the 1972 World Congress of Accountants, the International Accounting Standards Committee (IASC) was established of which Australia was a founder member.\(^{692}\) A lengthy debate followed between international accounting standard harmonisation and use of international accounting standards as

\(^{690}\) AASB 1014 ‘Set Off and Extinguishment of Debt’ requires set off if a legal right of set off is found and the intention is to settle on a net basis. Specific requirements are also found in AASB 1020 ‘Income Taxes’ on the set off of tax assets and tax liabilities.

\(^{691}\) Changes in the standard relative to the previous AASB1034 include: ‘accounts payable’ is now referred to as ‘payables’, ‘borrowings’ are referred to as ‘interest-bearing borrowings’, ‘tax liabilities’ are a separate category and includes all tax liabilities (not only income tax) and ‘provisions’ specifically exclude ‘tax liabilities’.

\(^{692}\) The IASC arose in 1973 (Faggotter, 1978, p175) from decisions considered at the 1972 World Conference (Balmford, 1977, p547). Both writers were more concerned with institutional and professional issues and it would take some years before those concerned with information type ones would be examined.
ready-made for adoption in a country. Up to the early 2000s, Australia followed the former approach.

The framework (IASB, 2001; 2003, p11) has as its purpose 'to facilitate the consistent and logical formulations of IFRSs' and to provide 'a basis for the use of judgement in resolving accounting issues' (www.iasb.org). Again there are distinct levels of abstraction.\(^\text{693}\)

Under Purpose and Scope, discussion is basically similar to that of the FASB framework. Some institutional differences are identified (FASAC, 2004c, p2-3), but of interest to this study is Para6 which introduces the idea of general purpose financial statements. Key points (met previously in Chapters 3-5) are also made:

- Para7 - that financial statements form only part of the process of financial reporting.
- Para10 - that financial statements cannot meet all of the information needs of the users identified in Para9, including management (para11).

This arguably differs from the FASB CF, as summarised in Figure 7.2. The IASB deals with financial statements\(^\text{694}\) whereas the FASB deals with general purpose financial reports which include both financial and non-financial information (FASAC, 2004c, p4). In Australia, 'Etc' may include the Corporate Governance Statement required from listed companies.

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\(^{694}\) The information provided in the financial statements is to achieved via statements of financial position (though this includes reference to economic resources), performance, changes in financial position and notes and supplementary schedules.
Discussion of Level 2 (para12-21) begins with the objective of providing ‘information about the financial position, performance and changes in financial position of an enterprise that is useful to a range of users in making economic decisions.’ A potential tension arises among CFs from the link between users and ‘equity’. A narrow definition (FASAC, 2004a, p4-5) is used to suggest shareholders only while a broader definition suggests a range of users. In a latter section on financial instruments, this is shown to have implications for the definition of ‘liability’.

That financial statements do not provide all the information users may need to make economic decisions is reinforced (para13). Two reasons are provided. First, ‘they largely portray the financial effects of past events.’ Implicitly, future (and selected contemporary) effects may be excluded. Second, necessary non-financial information may not be provided. This issue has seen the CF questioned (McCrossan, 2005), especially as consistency is sought to the reference to economic decisions.

The CF is suggested to be modified to include ‘credible statistical information’.

In this thesis, it is argued that such data is part of an economic CF while the financial CF, as found for example under CoCoA, is more constrained. This modification also has implications for other levels of a CF.

The idea of stewardship (met in Chapters 2-5) is introduced. It is pointed out that users need to assess that stewardship in a context of the making of economic decisions. Illustrations given are holding or selling of investments and to retain or replace the management - Chambers' adaptation issue.

That economic decisions are to be made are again stressed (para15-21). Included is the development of financial indicators on financial structure and of liquidity and solvency (para16). As regards performance, profitability is stressed, again in a context of economic resources. It is pointed out that information about performance is important to predict the capacity to generate cash flows given the stated position and to evaluate the effectiveness of further investment. Unlike the recent Australian standards, the balance sheet is seen to be synonymous with a statement of financial position and performance is reported in an income statement (para19).

Underlying Assumptions (para22-23) refer to the accrual basis and the going concern assumption which are not explicitly listed in FASB framework (FASAC, 2004c, p5). The latter discusses the conventional measurement of elements and

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695 McCrossan (2005, p15), 'Should the conceptual framework not first be modified to accommodate the use of credible statistical information consistently and experience gained with the reliability of using these statistically credible probabilities, before a change is mandated to incorporate probabilities that would have much lesser reliability (as in the use of "own credit rating")?'

'All of the examples ... involve to some extent or another estimating customers' behaviour (in the very broad sense including probabilities of inaction/inertia, anti-selection, moral hazard, death and morbidity).'

696 Para14, 'Financial statements also show the results of the stewardship of management, or the accountability of management for the resources entrusted to it.'

697 McCrossan (2005, p16-17) argues for a modification as this 'appears solidly rooted in recording the past rather than in recognizing the likely changes in control of economic resources ... that flow from past decisions.' The likely changes may include future probable matters.
explicitly discusses neither the adaptation notion of Chambers nor the capital maintenance/sustainability argument. The latter point is briefly raised at Level 6.

Qualitative Characteristics of Financial Statements (para 24-46) are basically similar to those of the FASB (FASAC, 2004c, p6-7). Introduced are four principal characteristics.

- 'Understandability' incorporates the assumption that users (para 25) 'have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.' This has implications for the terminology debates to be met in Chapter 8.

- 'Relevance' is discussed within the context of economic decision-making (para 26). A predictive role of information and a confirmatory one are stated to be interrelated (para 27). The characteristic subsumes the concept of materiality (para 29-30).

- 'Reliability' is discussed under a series of characteristics of a similar nature. These are implicitly of a different level of abstraction - perhaps they might be termed sub-characteristics? They include 'faithful representation' (para 33-34), 'substance over form' (para 35), 'neutrality' (para 36), 'prudence' (para 37 - the conventional accounting principle of 'conservatism' perhaps?) and 'completeness' (para 38).

- 'Comparability' is discussed in the context of users' ability to compare financial statements for an entity over time and to be able to compare those among entities. Consistency is sought (para 39) for an entity over time and among entities. Special mention is made of accounting polices being disclosed (para 40) and if a change is made, the effects are to be disclosed. Comparability is not to be (para 41) confused with uniformity - a suggestion sometimes made and changes proposed in developing accounting principles, especially in USA.

Two other sections are found regarding qualitative characteristics. These are to temper the principal characteristics:

1. 'constraints on relevant and reliable information' which incorporate 'timeliness' (para 43), 'balance between benefit and cost' (para 44) and 'balance between qualitative characteristics' (para 45).699

2. 'true and fair view/fair presentation'.

Little may be inferred from the latter, although implicitly it seems to hint at a technical meaning. It is suggested (para 46) that the application of the qualitative characteristics and accounting standards normally results in financial statements that

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698 McCrossan (2005, p17), as expected, questioned this discussion. He suggested a new paragraph, 'To be deemed reliable, information regarding future events concerning control of economic resources should be based on all material current credible probability estimates of frequency, magnitude and timing. In the absence of relevant credible estimates, there should be a presumption that the information is potentially misleading.'

699 This is seen as an area for professional judgment.
convey what is generally understood as a true and fair view of, or as presenting fairly such information.' Debate remains as to that general understanding.\textsuperscript{700}

The next three sections deal with financial statements at Level 5A - Elements (para47-81), Level 5B - Recognition of elements (para82-98) and Level 5C - measurement of elements (para99-101) respectively. Level 5A deals with the statements of financial position and performance. It begins (para47) with the claim financial statements portray the \textit{financial} effects (or transaction and other events), classifying them according to their \textit{economic} characteristics. This is consistent with the argument that \textbf{financial} is a subset of \textbf{economic} but it may also be inferred that \textbf{conventional accounting} also is a subset of \textbf{economic}.

Assets, liabilities and owners’ equity are the elements to be measured to present ‘financial position in the balance sheet’. This suggests that financial position and balance sheet are synonyms. That this is not so is shown in later – and possibly inconsistent – argument. The elements of performance are income (rather than revenue) and expense.

The elements of position are defined (para49) in a way basically similar to that of FASB (FASAC, 2004c, p6).\textsuperscript{701} That of liabilities reads, ‘A liability is a present obligation of the enterprise arising from past events, the settlement of which is expected to result in an outflow from the enterprise of resources embodying economic benefits.’ McCrossan (2005, p18) would incorporate ‘using all current credible material information when estimates are made.’ It is suggested that both frameworks face problems regarding ‘liabilities’ (FASAC, 2004b). This will be returned to in Section 8.4.

The IASB framework then points out (para50) that this \textit{definition} (for financial position) does not apply necessarily to a balance sheet. The reasoning is the application of \textbf{recognition} criteria (Level 5B). Figure 7.3 highlights the argument.

\textbf{Figure 7.3}

Financial position [includes] Liability as defined

Balance Sheet [includes] Liability as recognised

\textsuperscript{700}Clarke et al (2003, p306), ‘Virtually everybody will have experienced calculating that way in respect of their own financial affairs, business or household, when they desire useable financial information as a basis of periodic assessment and evaluation. It does not require the invention of a special “conceptual framework”. To everybody who has purchased and sold, handled money, faced prices and price structures, experienced the differential impact of changing prices and price levels, such things are unexceptional, common commercial knowledge, not peculiar to accounting.’

\textsuperscript{701}McCrossan (2005, p18) suggests a major change here, ‘Expectations ... should be based on all material current credible probability estimates.’ For assets, he suggests, ‘However, while physical form is not essential to the existence of an asset, in the absence of physical form when the asset is an expectation of a future economic resource, current credible estimates concerning frequency, magnitude and timing of any future economic resources that arise from past transactions or other past events are expected.’
When applying the definition (para 51), 'attention needs to be given to its underlying substance and economic reality and not merely its legal form.' Figure 7.4 highlights that argument.

**Figure 7.4**

\[
\text{Application of definition} = f(\text{legal form, underlying substance, economic reality}).
\]

No discussion of these independent variables is provided.

The definitions are elaborated on in later paragraphs. As regards liability, the term obligation is seen (para 60) as 'a duty or responsibility to act or perform in a certain way.' Some such actions/performances are legally enforceable – by contract or statute. Others are of a moral/equitable type – by culture, custom, ethics or normal business practices. A time frame is also important (para 61). Present obligations arising from past transactions or events (para 63) are liabilities.

Application of the definition varies according to another variable - the degree of estimation in related measurement. This (para 64) is linked to the term 'provisions'. It is pointed out that some countries have a narrower definition of liability which excludes any estimation. Others, including that used here in the IASB Framework (para 64), follow a broader definition.

The elements of performance – income and expense - are defined (para 70) in part in terms of changes in the amounts of liabilities. It is pointed out (para 77) that income may result from the settlement of liabilities – a moot point to be returned to in 8.4.

As regards Capital Maintenance Adjustments,\(^7\) the revaluation or restatement of assets or liabilities (para 81) meets *prima facie* the definition of income or expense. However, it is pointed out that under some concepts of capital, these items may be included wholly (CCA) or partly (CoCoA) in equity as a capital maintenance adjustment reserve.

Discussion of recognition provides the reasoning for items to appear in the financial statements. As regards liabilities, this is part of a balance sheet – not necessarily a statement of financial position (para 82). As highlighted in Figure 7.5, as well as the independent variables of the application of definition (Figure 7.4), two other variables (para 83) are introduced - probability of future economic benefit, reliability of measurement.

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\(^7\) Clarke *et al* (2003, p278), 'The key features of his CoCoA system are: all assets will be stated at their current cash equivalent (for vendible physical assets generally best indicated by their market selling prices at the reporting date); income is all-inclusive, including all gains and losses arising in the worth of assets during the period under review. Gains and losses in the general purchasing power of money are brought into the income calculation by means of an annual capital maintenance adjustment. Accordingly, all inter-corporate and other investments would be stated at their current cash equivalents – that is, they would be marked-to-market.'
Both are briefly discussed (para 85 and paras 86-88 respectively). If the criteria are unable to be met, then resort is to be had to 'the notes, explanatory material or in supplementary schedules.' However, issues like the weighting to be placed among even those two variables are lacking.

Figure 7.5

Application of recognition = f(application of definition, probability of future economic benefit, reliability of measurement)

= f(legal form, underlying substance, economic reality, probability, reliability).

The argument then moves to particular liabilities (para 91). The case of equally proportionately unperformed contracts is briefly raised but little is explicitly concluded.

In the discussion of Level 5C (para 99-101), four bases of measurement are mentioned,

- historical cost,
- current cost,
- realisable (settlement) value, and
- present value.

The third basis is a variation on CoCoA and will be further discussed in Chapter 8. Discussion at this level is basically similar to that of the FASB, though issues like derecognition and of measurement remain (FASAC, 2004c, p7-8).

Discussion of Level 6 begins with the various concepts of capital. These are divided into financial capital (also adopted by FASB) and physical capital. The former is in turn divided into invested (or nominal) money and invested purchasing power (para 102-103). Nominal monetary units, units of constant purchasing power or physical productive capacity/operating capability are to be maintained, depending on the concept adopted. It is pointed out (para 103) that measurement difficulties are found in attempting to make the third method operational. It is usually (para 106) discussed within the context of CCA. The problem of choice among the four bases is basically unresolvable as shown (para 110) by the concluding comments in which the various models (including CoCoA) are simply introduced.

In developing CoCoA, Chambers (1978, p122) used a notation which included his definition of capital \(^{703}\) and how it was to be maintained. \(^{704}\) The notation demonstrated the consequences of changes in

\(^{703}\) Chambers (1966a, p122), ‘The capital of an entity is its unrestricted stock of assets.’ It is maintained by applying to that capital (p256) the relative change in the general price index between [the start of the period] and [the end of the period]. The later is designated as the ‘capital maintenance adjustment’ and recognised as an expense.

\(^{704}\) Chambers (1978, p122), ‘In 1961 I devised a notation for dealing in general symbolic terms with the features of the financial position and changes in the financial position of a firm from time to time. The
• prices of assets, and
• prices in general.

His notation was to provide rigour to the level of debate found in the literature. Chambers applied the argument to the financial position statement which included

• the current cash equivalent of assets, and
• the amount of liabilities.

Both groups were expressed in the amounts at the stated date. Note that Chambers saw liabilities at [contractual] amounts rather than them being marketable items.\textsuperscript{705} This issue is further analysed in Chapter 8. However, an adjustment was required to allow for changes in the money unit during the period, which Chambers incorporated into the argument.\textsuperscript{706}

The notation was copied by CCA proponents Mathews (1965; 1967; 1968) and Gynther (1966; 1970) and used in debate. The exchange with Mathews led to some refinement of Chambers' argument,\textsuperscript{707} but in its application to CCA, Chambers identified various fallacies.\textsuperscript{708} The use by Gynther too was shown to be fallacious.\textsuperscript{709} Chambers examined Gynther's argument in more detail as regards the

• treatment of liabilities,
• nature of long-term liabilities,

object of the notation was to give rigour to the demonstration of the consequences of changes in the prices of assets and changes in the general purchasing power of money. Much of the "argument" occurring in the expositions of accounting was characterized by \textit{ad hoc} supplements to stated (often vaguely stated) general rules. One way of cutting through the labyrinth is to reduce the elements of the matter to their simplest form, and to derive results from stipulated premises by explicit reasoning. That is the method of explication used in other fields, from formal logic and mathematics to natural science and economics.\textsuperscript{7}

\textsuperscript{705} Chambers (1978, p127), 'No problems arise in respect of balance sheet amounts at a stated date; for all amounts discovered to be indicative of the current cash equivalents of assets and the amounts of liabilities are expressed in the money unit of general purchasing power at that date. But where a difference, such as income, is to be found by reference to measurements at successive dates at which the money unit is not in all respects the same unit, an adjustment must be made to one or other of the initial and terminal measures.'

\textsuperscript{706} Chambers (1978, p129), 'By early 1969 it occurred to me that the assumption of a "transactionless period" could be abandoned. Under the cash equivalent or money equivalent rule, we have a set of measured amounts at t\textsubscript{1} expressed in a common denominator. Whatever may have occurred in the interval is captured by the difference.'

\textsuperscript{707} Debate dealt with 'more than formal differences' (Chambers, 1967a, p215), but further analysis here is beyond the scope of this thesis.

\textsuperscript{708} Chambers (1978, p123), 'A short-cut identification of fallacies or solecisms will make it possible to designate the kinds of problems which have arisen in the literature. They are based on certain logical or practical considerations or imperatives. It is presumed that we are seeking a rigorously specified system of which the operations of addition, subtraction and relation are necessary elements. We shall refer to "addition", as subsuming subtraction and relation.'

\textsuperscript{709} Chambers (1978, p123), 'The formulation of Stage I (1961) was adapted by Gynther [1966] in the setting of advocacy of a form of current cost accounting. As did Mathews, Gynther used \(N\) as representing the \textit{costs} of non-monetary assets. For reasons already given, the initial and terminal expressions representing balance sheets are examples of the \textit{fallacy of heterogeneous aggregation}.'
Chambers took issue with Gynther’s use of only current liabilities in his calculations.\textsuperscript{710} Gynther was certainly trying to minimise any ‘gain’ on liabilities in times of rising prices. Chambers challenged the logical consistency of the argument. He pointed out that as long-term debt differed from shareholder contributions both in law and in financial effect, Gynther had erred in his identification of those elements.\textsuperscript{711}

As regards the idea of a physical capital, Chambers drew on the work of Hicks (1946).\textsuperscript{712} There one finds various viewpoints termed ‘fundist’ and ‘materialist’. Accountants were usually placed in the former category as accounting was concerned with wealth and income determination for individuals and firms.\textsuperscript{713} Given the

\textsuperscript{710} Chambers (1978, p135), ‘Gynther was concerned to show that, to “protect” a “capital” in a period in which the “price level” rises by the proportion p, “it is necessary to supplement the automatic increase in non-monetary assets”, (pN), by p(M-L), where M represents monetary assets and L represents current liabilities. “...the profit-determining process must include profits and losses on monetary assets and non-permanent liabilities in times of changing prices.” Presumably “include” means “take account of”, since the amount of pN was to be transferred to an asset revaluation account and the amount p(M-L) was to be transferred to a “capital reserve”.

The symbolic demonstration was not extended to the case where the current costs of non-monetary assets rose by a proportion different from p; nor to the case where there are long-term liabilities. But following the demonstration, Gynther argued that gains in respect of long-term liabilities should not be taken into account in calculating the profit of a period. Now, why gains on short-term liabilities should be taken into account, and not gains on long-term liabilities, is difficult to understand in the context of an exercise in measurement. For, first, short-term liabilities may, by renewal, have the same effect as long-term liabilities; and second, lenders for short and long terms both suffer losses in general purchasing power, which must correspond with the gains of borrowers, since there are no other parties to the transaction. The separate and distinctive treatment of different classes of liability is an example of the fallacy of improper subdivision.’

Gynther, under whom this researcher studied and worked in the early 1960s, was a supporter of the entity theory in which management was the primary stakeholder whose interests were to be protected. Thus he was in turn a strong supporter of CCA. From discussion at that time, Gynther was unhappy about the inclusion in profit determination of the (usually positive) effects of inflation on the long-term liabilities of an entity. This economic gain not only offset (in part) the effect of increases in costs of replacement of non-monetary assets but also was available as profit to shareholders (provided tests of solvency were met).

\textsuperscript{711} Chambers (1978, p135), ‘Gynther sought to justify the distinction on the grounds that long-term debt forms “part of the permanent capital of the firm” as are amounts contributed by shareholders. Of course, long-term debt is not the same as shareholders’ contributions, in law or in financial effect. To assert that it is, is an example of the fallacy of mistaken identity.’

\textsuperscript{712} Chambers (1978, p142), ‘Being concerned largely with the logic of a formal demonstration, little has been said about the empirical validity of the use of a “physical capital” as an object of managerial concern or the maintenance of a physical capital as a desideratum for the calculation of income. Hicks [1946] has characterized the differences between two kinds of viewpoint by the terms “fundist” and “materialist”.

\textsuperscript{713} Chambers (1978, p142-143), ‘There are some economists whose expositions run in terms of stocks and changes in stocks of material wealth, physical goods. But such stocks are treated in general terms, seldom if ever in terms of specific quantities of specific goods.... On the other hand, there are some who conceive capital as a “fund”, expressed as a money-quantified stock of means. Hicks considered accountants as falling usually within this category. Now, whereas it may be proper to disregard debts and money balances as irrelevant in the context of a community as a whole, it is not proper when account must be taken of individual rights in the means of exchange, and
difficulties faced in the specification and quantification, Chambers questioned the use of physical capacity\textsuperscript{714} as a concept of capital for accounting – a key element in CCA (and Gynther's argument) – because it lacked empirical validity. Instead, Chambers argued for adaptive behaviour – a key point of his CoCoA.\textsuperscript{715}

Arguably, CF projects and related research see a continuation of tensions and related recycling of issues, especially at the information level. This is further shown by a consideration of AAS,

### 7.2.5 CF projects and accounting standards

As identified earlier, CF projects were to provide logical rigour and prevent inconsistencies among AAS. Analyses continued to test whether this was so. Staunton (1977a) examined USA standards regarding liabilities, concluding (p77) 'various common threads ... suggest interrelationships among apparently distinct problem areas.' However, problems persisted. Howieson (1993) identified inconsistencies between SAC 4 and AAS, while Gibson & Goyen's (1996) survey of the AAS identifies at least seven different methods for valuing assets.\textsuperscript{716}

Miller and Loftus (2000, p6-7) provide a summary of the use of measures which deviate from historical cost as found in Australian standards. As regards liabilities, they highlight,

- finance leases
- employee entitlements
- foreign currency items
- superannuation funds
- general insurance entities and outstanding claims
- life insurance items

in treatments of the wealth of individuals and firms. And that is the function of accounting for individuals and firms.

'The 'fundist' and "materialist" notions, on these grounds, are neither compatible nor incompatible per se. They simply relate to quite different contexts of discourse.'

714 Chambers (1978, p143), 'It is notable that no "materialist" economist has attempted to quantify material wealth in terms other than those used by fundists. Material wealth or physical capital is not quantifiable in terms of a common denominator. Indeed, it is notorious that none of the materialist accountants has attempted to specify what is meant by physical capacity, operating capacity or operating capability. In the absence of a specification, no firm meaning can be assigned to the maintenance of physical capacity, and no dependable calculation of the "financial" variety can be based on notions of the "physical" variety. That is why the makeshift substitution of replacement and replacement cost has been made to serve.'

715 Chambers (1978, p143, 'But there is no rule of business administration or economic behaviour which entails that a physical capacity or a stock of material goods should be maintained. The adaptive behaviour characterized by the description "economically rational behaviour" entails that firms will seek the most promising deployment of the money (general purchasing power) that comes under their control day by day. In the face of shifts in demand and technology, it would be folly to insist routinely on replacing physical goods.'

716 These included cost, allocated cost, current cost, net realizable value, present value, recoverable amount and fair value. As well, the authors identify nine further 'unclassifiable measures'. West (2003, p76) suggests, 'It is beyond contemplation that such a diverse array of valuation techniques could act as proxies for a single dated attribute and be capable of sensible aggregation.'
• public sector infrastructure matters.

Loftus (2003) identified inconsistencies among SACs 1–4 and AAS, concluding (p308), ‘Too much of the foundation has been left in limbo.’ This was certainly the case of emerging issues like derivatives. Bradbury (2003, p388-390) traces the development of standards for accounting for financial instruments. They range from simple, everyday items like cash, receivables and payables to complex derivatives like options and warrants. He (p396) argues that existing SACs of the CF require significant refining to deal with new complex derivatives.

Perhaps a report like the Corporate Governance Statement, which is discussed in the next section, needs to be better linked to the financial statements.

7.3 Social reporting

The idea of social accounting (recall 6.4.1) is not new. Hartzell (1934, p162) clearly argued for a broader reporting function.717 Farman (1951, p37) also saw accounting encompassing matters at the widest level.718

Within that context, irresolvable debates continue as the parties argue at different levels.719 A framework is required within which issues can be rationally debated so that a considered, transparent conclusion follows. This is accountability at its broadest. Indeed, Gaffikin (2003a, p295) argues that Mattessich's works (which introduced more rigour into accounting from greater use of mathematics) sought to integrate accounting (micro) with national income accounting (macro) and make accounting more goal oriented. This would certainly broaden the range of accounting.

As noted during earlier chapters, the basic responsibility of management in corporations has changed. The investor of funds was no longer the sole concern of management as a system of community obligations to employees, consumers and the general public was developed. If necessary, government would act to ensure these corporate responsibilities were met (Hawkins, 1962, p411-412).

Arguably, management of corporations was required to develop a conscience, thus avoiding government regulation. This conscience required certain rules, designed for

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717 Hartzell (1934, p162), ‘The opinion may be hazarded therefore that there will be a movement toward a resolution of costs which may be called Social Accounting, the objective of which will be the harmonization of the viewpoints of the business firms and human interests at large by tracing the effects of particular policies on groups other than those directly concerned.’

718 Farman (1951, p37), ‘The third of the three groups of initial decisions which must be made in social accounting, as in all accounting, is the determination of the accounting process to be followed. This covers and includes questions of system design and mechanics, account captions and terminology, types of reports, disclosure, etc.’

719 Suppose the following scenario, based on an actual case reported in Sydney (Mitchell, 1995). An Opportunity Shop, part of a larger charity group, has a favourable location in a well-established, wealthy suburb. It is staffed by volunteers and is seen by the not so young as a place to call in to have a cup of tea and a chat. The shop financially breaks even, due in large part to the lack of salary costs. However, head office looks at the economic situation, and decides that the shop should be closed as the resources would produce a higher return (both financially and economically) by moving to another location and the present location sold or leased. The locals, both volunteers and users, argue that the net social benefits are so positive that the shop should be retained.
the protection of individuals, to be observed (Berle, 1954, p113-114). However, a weakness was that corporate management represented a profit-making enterprise. Economic relations (which in turn affect social relations) require a broader base than that of a mere financial income statement. Corporate representatives working in foreign countries and corporate managements increasingly required an understanding of this issue (Berle, 1954, p141).

Philosophical considerations were seen to have consequences for corporate management. These included various kinds of community and potential changes occurring from a large corporation being established in that community. Some argue issues of community welfare were beyond the functions of management mainly as it remains difficult to plan. Others argue for corporate management involvement in the context of community living. Arguably, corporate managements were trustees for the entire community (Berle, 1954, p166-167).

The debate was resolved in favour of management of corporations supporting non-governmental philanthropic and educational institutions. In USA, various states enacted statutes to authorize corporations to make such contributions. Ability to have such major functions in a community would continue to have interactions with any required accounting.

UK research study by Swift et al (2001, p10) argued the trend towards social reports suggested a change in attitudes from a predominantly managerial emphasis to one of collaboration with other stakeholders regarding social issues. Further, it is suggested that a MIS infrastructure be developed to underpin the whole - social, economic and financial - reporting process. A most popular method of social reporting is the balanced scorecard. However, they cautioned this basically internal management tool might not be readily translated for disclosure to external stakeholders. They also illustrated various measures to be used, mainly non-financial ones.

Various reporting entities and their trade organisations have developed guidelines for the preparation of reports which are seen as distinct from the data included in the Annual Report to shareholders. One difficulty met concerns the use of financial or

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720 Berle (1954, p168-169): 'Constitutional validity of one of these statutes - that of New Jersey - was the subject of a recent test case (A. P. Smith Manufacturing Company v. Ruth Barlow, et al.) and was forthrightly upheld by the New Jersey Supreme Court. The Supreme Court of the United States dismissed appeal, holding that no Federal question was involved. For practical purposes, the state has authorized corporations to withhold from their shareholders a portion of their profits, channelling it to schools, colleges, hospitals, research, and other good causes.'

721 Heritage 'assets' would certainly be part of social reporting. Debate is found however, as to whether (and if so, how) they should be reported in financial terms (Carnegie & Wolnizer, 1995, 1999; Micallef & Pierson, 1997). Issues arise at the financial reporting level as to control, ability to dispose of and current cost of replacement. The use of qualitative and non-financial information has been suggested.

722 Howden (2004, p25) writes, 'A new code for reporting standards for biotechnology companies should encourage investment in the sector...' The code is being developed by members of the biotech industry and the ASX. 'The ASX said the code was in response to perceptions that more "regulatory rigour" should be applied to the industry and to bridge the information gap between it and the investment community.' One concern was the confidentiality issue.
economic values to measure selected social issues. For instance, Australian Bureau of
Statistics (2002) produces fifteen (15) indicators which are used to report the present
position of and changes over time in general wellbeing. Four (4) indicators of an
economic nature, five (5) are of a social nature and six (6) deals with environmental
issues.

The first of the social indicators concerns education and training, the second life
expectancy, the third issues regarding housing, the fourth on crime and the fifth about
'social attachments'. The first of the environmental indicators concerns the numbers
of extinct or endangered bird or mammal species, the second is on land clearance, the
third on land degradation, the fourth on inland water, the fifth on greenhouse gas
emissions and the sixth concerns air quality.

In a review of that publication, Gittins (2002) argued it provided a national
stocktaking which, over time, answered whether life had been getting better or worse.
Gross domestic product was seen as too narrow and misleading as a measure of the
change for social performance questions. However, he warns of attempts to add up
these fifteen indicators! This 'national stocktaking' provides a social position
statement at distinct points. Social performance may be reported by changes in that
position between distinct points in time.

That is not to say that financial nor economic data are unimportant regarding issues
of social concern. Staubus (1977, p75) sees links between financial and social
accounting.723 However, he did highlight difficulties – like quantification and
operational issues – met in the distinct accountings.

At a different level, Johnson (1954, p224) saw links among the various
accountings.724 Like Chambers, Johnson argued that various choices were based on
reasoned preferences, including those linked to ‘business income’. While some saw
this in terms of financial criteria only, others would incorporate social criteria as
well, Johnson warns of unstructured debates over superiority; each accounting has a
function to be attained.

Certainly the financial statements of a company have been consumed by a broader
reporting. An early suggestion of change (ASSC, 1975) suggested that users including
shareholders required an accounting much wider than simply a financial one. More
recently, the Global Reporting Initiative (GRI) was established in 1997 under the

723 Staubus (1977, p75) writes, 'Maximization of social welfare is as appropriate a goal of decision
making in the areas of external financial reporting as it is in any other public policy area but,
unfortunately, it is also almost as difficult to quantify in the former domain as in others. Until a
mathematical model of the social welfare approach becomes operational, if it ever does, those who are
faced with accounting choices may be able to improve their decision-making techniques by identifying
and applying a set of criteria of desirable accounting methods.'

724 Johnson (1954, p224, emphasis added): 'It will be necessary to start from a premise as to the
criteria by which business income is to be judged. It should be clear at the outset that an appeal to
fundamental or immutable laws or principles as a basis for making a choice is futile. Business income
is a social concept derived from the desire for useful information concerning the affairs of the
enterprise. Reasoned preferences may therefore be expressed, to be judged in the light of experience,
but a search for proof of superiority is a chimerical quest.'
collaboration of the Coalition for Environmentally Responsible Economies and the
United Nations Environment Program. This is an international, long-term and
multiple stakeholder undertaking with a mission to develop a framework for the
reporting of information not presently found in conventional financial reports of
corporations.

This would see the promotion and dissemination of voluntary guidelines for
sustainability reporting of the economic and environmental/social dimensions of the
activities, products and services (details at www.globalreporting.org). GRI reporting
was to complement conventional accounting and financial reporting by providing
non-financial information for users in their assessment of performance of
corporations.

Draft guidelines were issued in 1999. After pilot testing, comments from interested
parties and revision, the guidelines were released in 2000. A further update was
released in 2002. The guidelines recommend reporting under five sections:

- Vision and Strategy
- Profile
- Governance Structure and Management Systems
- GRI Content Index
- Performance Indicators.

A similar undertaking was carried out by the Australian Conservation Foundation. It
produces a 'Perception Report' on the environmental performance of Australia's top
100 companies (www.acfound), nick-named the 'Good Reputation Index'. Strong
criticism continues of the reporting of environmental performance by large Australian
companies which are seen as 'paying lip service to the environment and failing to
change the way they did business' (Anonymous, 2004, p4). A similar reporting
requirement has been launched called RepuTex Ratings System (Hewson, 2003,
p70).  

Cook (2003, p40) cautions that some scepticism may be necessary in the use of the
phrase Corporate Social Responsibility (CSR) by management and speeches of
business leaders. CSR covers sustainability, diversity and old-fashioned philanthropy.
However, recalling Bhopal, Enron and the sweatshops of the Far East, he
questioned whether the motives underlying CSR are not necessarily to restore public
faith in business and save the planet, but perhaps rather CSR reflecting nifty footwork
and smart PR designed to thwart opposing pressure groups and avoid government
regulation.

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726 This is illustrated in the exclusion of a large Australian listed company from the index for being
involved in bribery claims (Syvret, 2006, p25).

727 Cook (2003, p40): 'Look at Enron's last CSR report. Sprinkled with images of sunlit foliage and
smiling ethnic faces, it dwells on how the fraudulent energy giant conserved trees in Bolivia and told
the security men at its Indian subsidiary to stop beating people up. Former chairman and CEO Kenneth
Lay waxes lyrical about his firm's "innovative practices". For students of irony, the whole thing is a
delight.'
The role of social (including environmental) tragedies in improvements in CSR reporting may be similar to that of financial collapses and frauds on financial reporting. For example, arguably the Bhopal case for Union Carbide or the Exxon Valdez case (Estes, 1996, p41 and p188 respectively) increased public awareness of reporting practices in that area. A crisis in corporate reporting may easily raise questions which go far beyond simply financial sustainability. A business failure (Ansett as cited in Clarke et al, 2003; One.Tel in Clarke et al, 2003; Barry, 2002) often provides an illustration of the fundamental importance of corporations and their activities - financial, economic or social - in the livelihoods of stakeholders other than the shareholders.  

In Australia and elsewhere, corporations (when listed) are now required to include a CG Statement. It usually includes non-financial data and is built around various strategic committees. Various issues are highlighted and includes data which would be useful in decision-making (or Chambers' 'economic behaviour' or 'action') and accountability as proposed in the CF. However, it would certainly be broader than financial statements under CoCoA and arguably under conventional accounting with its narrow stewardship.  

This statement now has standards against which applications may be compared. Heathcote (2003, p68) comments on the then release (in July) by Standards Australia of a set of five (non-mandatory) standards on CG:  

1. AS 8000 Good governance principles,  
2. AS 8001 Fraud and corruption control,  
3. AS 8003 Organisational codes of conduct,  
4. AS 8004 Corporate social responsibility, and  
5. AS 8005 Whistle-blower protection programs.  

While in Australia there is no assurance report on the CG Statement to provide explicitly an opinion, the independent auditor of the financial statements is required to ensure that data provided in the other sections of the annual report (including CG) are not inconsistent with information in the financial statements. Andrews (2004, p71) comments on a KPMG study of the implementation by Australian listed companies of the ASX recommendations on CG. Problems were met with Principle 4 and Principle 7.  

Principle 4 has to do with reporting integrity. It is recommended the chief executive officer (CEO) and chief financial officer (CFO) state in writing to the board that what  

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728 Williams (2003, p267) suggests, 'Maybe future political, social, or environmental events will shake the current faith in economic institutions leading to different roles for accounting.' One such event may be the inclusion in reports of related social/environmental type liabilities like the asbestos related liabilities of companies.  

729 This is consistent with Merino (2003, p287), 'As late as the 1960s, SEC commissioners disavowed the notion that the regulation was designed to provide information for decision making. If the SEC had been serious about providing information for decision-making, then a statement of accounting policies should have been required in annual reports, which were far more accessible for the average investors than were registration statements.'
is presented is a ‘true and fair view’ of the company’s financial condition and operating results. Further, the presentation was to be in accordance with Australian accounting standards.\(^{730}\) CEOs and CFOs sought clarification before signing off, debating whether the principle ‘added value’. Principle 7 covers statements by CEO and CFO on the integrity of risk management and internal control. As well, confirmation was sought of the effectiveness and efficiency of risk management and control compliance.\(^{731}\)

However, corporate management (often with vested interests) continues to seek access to flexible AAS in the calculation of income, especially if, under a performance-based remuneration plan, they have an interest in the market price of their company’s common stock. As the reported income of their company may affect that market price, options to executives to take up stock provide an immediate personal interest in that reported income.\(^{732}\) Further interest to keep the market prices high may be provided by the continual need for new funds\(^{733}\) from shareholders or debt holders and by the acquisition of other companies through share swaps rather than by direct purchase. Of interest may be the risk element of any derivative positions – part of the CG Statement.

Arguably, under the ‘positive’ approach, the power which resides in corporate management hands would be balanced by market forces.\(^{734}\) However, Berle (1954, p37-39) cautioned that re-examination of this control was needed in light of changes in the corporate world. His conclusion was based on a study of his in 1953 which included information much of which was of an accounting kind.\(^{735}\) In a market place where a competitive system is found, the least efficient units or those worst-placed strategically would in principle be eliminated (by withdrawal, bankruptcy or consolidation). However, if the consolidation is to a large corporation seeking ways to maintain itself and if many small units disappear, monopoly eventuates. As shown in Chapter 2, instances in the last half of the nineteenth century of actual and potential monopoly led to controls being established in USA (Berle, 1954, p45-46).

\(^{730}\) Of the 68 companies sampled, 48 did not meet this recommendation.

\(^{731}\) Here, of the 68 companies sampled, more than 48 did not meet this recommendation.

\(^{732}\) The bonus plan hypothesis of PAT tests whether management seeks to select accounting methods to increase reported income (Watts and Zimmerman, 1986, p138). In the popular literature, this idea is found in novels like Crichton (2002, p183).

\(^{733}\) The debt/equity hypothesis of PAT tests whether for firms with higher debt/equity ratios, management select accounting methods to increase income (Watts and Zimmerman, 1986, p139).

\(^{734}\) Berle (1954, p35) pointed out, ‘This was one of the tenets of the classical economists’ and added (p36) ‘Economists refer to it as “the judgment of the market place.” In economic theory this “judgment of the market place” is assumed to be a powerful controlling factor.’

\(^{735}\) Berle (1954, p39), ‘There is substantial evidence, which need not be reviewed here, that this is representative of the real pattern of the twentieth-century capitalism. The capital is there; and so is capitalism. The waning factor is the capitalist. He has somehow vanished in great measure from the picture, and with him has vanished much of the controlling force of his market-place judgment.’

251
7.4 Summary and conclusion
The CF projects were intended, as pointed out in Chapter 5, to provide consistency among accounting standards. However, tensions continue from failure to define financial reporting succinctly. Needs are apparent for the development of CFs both at the economic level and at the social level.\(^7^3^6\)

Argument
7.11 Granting of legal backing for AAS increased the power of lawyers who had formerly played the major role in 19th Century (Chapter 2).
7.12 Lawyers' arguments would be based on what is actually written in a particular AAS.
7.13 Developments continue beyond reporting of financial information, especially under environmental reporting.
7.21 Developments continue beyond reporting of financial information, especially in CG Statements.

Tensions continue to be found in the CF projects at the financial level and for related AAS. Unexpected large financial collapses continued. Those of the late 1980s-early 1990s were reviewed in a context which differed from earlier times.

Argument
7.31 The various blocks/levels of the CF highlighted potential argument among those levels.
7.32 Debate continued on the rate of change from conventional accounting.
7.33 Radical change was resisted, especially by preparers of reports and management.
7.34 SACs have a rocky existence as one is still to be developed for Block 1, major resistance was found to SAC 4 and SACs regarding Blocks on measurement were to see a lengthy gestation period.
7.35 Inconsistencies among accounting standards and the CF continue.
7.36 Muted criticism is offered of accounting data as arguably the CF project is seen to have improved AAS.
7.37 Criticism was concentrated on personal qualities of individuals, including accountants.
7.38 Few academic accountants debated the quality of financial information.

In both Australian and IASB frameworks, issues concerning liabilities continued to cause information tensions.

Argument
7.41 Liabilities arising from legal and social grounds intermixes two distinct issues, with interactions for financial ones.
7.42 The time frame adopted in CFs introduced anticipatory issues which led to tensions.
7.43 The degree of estimation allowed in the reporting of liabilities led to tensions in measurement (See Chapter 8).

\(^7^3^6\) The Economist (2005b, p29), '... a “framework” for a green GDP accounting system could be unfolded within three to five years. This would make China the pioneer of a statistical approach that no other country has adopted – and which many economists around the world eschew as an attempt to quantify the unquantifiable.'
7.44 Liabilities are to be recognised in principle in the balance sheet, but tensions remain from application difficulties seeing their recognition in notes or other parts of the annual report.

In the next chapter, issues of definition and recognition as well as measurement are further analysed.
Chapter 8 Incubation – Definition, Recognition and the Valuation Methods

The whole question of terminology is of such vital importance to the profession at large that it is probably quite unnecessary to emphasize it. No one who has been engaged in accounting is ignorant of the fact that there is no standard definition of many of the accounting terms which are in common use.... The best definition does not necessarily imply the most common interpretation, although in many cases it is wise to adapt technique to custom rather than to attempt to make custom conform to technical ideas.

Editorial, 1928b, p34-35

... the use of monetary calculation involves no assumptions whatever as to the values men hold. Money units are a device only; they are counters in the same way as are numbers.

Chambers, 1966a, p79.

Legendary value investor Warren Buffett once commented about the sharemarket: “For some reason people take their cues from price action rather than from values. Price is what you pay. Value is what you get.”

Hughes, 2005, p18.

8.1 Introduction
In previous chapters, it has been argued that accounting (in a broad generic sense), while a keystone of CG, incorporates reports of various types, including financial. It has been shown that present financial reporting includes past and contemporary financial statements as well as future-oriented statements. However, under CoCoA, contemporary financial statements are a dated financial position statement and a financial performance statement for a stated period, both statements being logically interconnected. These statements, even if there is full agreement on other Blocks of the CF, may differ from those using other valuation models. These differences led to vigorous debates in which Chambers was an active participant.

In Chapters 2 to 6 inclusive, it was shown that various accounting terms and phrases are used in CG (for instance, true and fair, financial position, asset or liability). It was shown that some users accept a vernacular interpretation while others suggest a technical one. In Chapter 6, an interlinked set of data for an accounting was introduced and a series of interrelated reports on position and performance were suggested. This in turn suggests a hierarchy of terms.

As discussed in Chapter 7, tensions in accounting continue at distinct levels. One level is at that of the underlying philosophy (or CF) of accounting. Another is that of the various parts of that philosophy. The former would include issues common to all theories: what is reality, what terms are to be used (like assumptions, doctrines, axioms, postulates, principles, concepts or rules) and what are the interrelationships among those terms. As well, a basic starting point is required in which the nature or function of accounting is identified. To the bewilderment of some (like Chambers, Sterling or Staubus), this has been long debated in the literature – without resolution.
Reasons for the lack of all-embracing definitions follow set themes. While areas of debate in accounting have arguably been narrowed, they still exist in respect of:

- definition,
- recognition, and
- measurement in general.

These have implications for the concept ‘liability’ in particular.

In this chapter, the terminology dealing with the element ‘liability’ is further analysed (8.2). This involves a restatement of a context including the position statements within an accounting. This is followed by discussion of tensions met regarding the element ‘liability’. In 8.3, the various uses made of the term ‘value’ are introduced. This is a key section leading to the valuation/measurement methods (8.4) argued and debated in the literature in general and of ‘liability’ within Chambers’ CoCoA in particular (8.5). A hierarchy of terms regarding liabilities is then proposed to resolve particular tensions (8.6). Finally, a summary and conclusions are presented (8.7).

8.2 Terminology for the element - liability

During the 1920s (see Chapter 4), Kohler (1929, p192) concluded,

Accountancy lacks definitions ... Textbooks have mostly shunned the responsibility of formulating cleanly-cut definitions, and the results obtained thus far by professional bodies have been almost nil.

General, universal type definitions were at that stage still sought in accounting. They had not been needed, as shown in Chapters 2 and 3, in earlier periods. Then it was possible to prepare an exhaustive list of items to be included in an accounting and for the processes necessary to provide that accounting. There was no need for abstract reasoning towards the formulation of universal concepts. Indeed, nowhere in Pacioli (Crivelli, 1924) is to be found a discussion of relationships among parties in the abstract. Instead, reference is found to particular relationships.

This approach was still found in UK at the end of the 18th century. However, even then some writers sought to establish general rules of guidance rather than rely on a set of rules only. Jackson (1956, p288, p295) refers to a general rule published by Hugh Oldcastle in 1588 and to distinct theories of accounts met when attempts were made to explain or rationalise those rules. However, during those times, rationalisation was rarely found.

The establishment of general rules by a process of abstraction and rational argumentation for guidance in particular situations was made necessary (as argued in Chapters 2 to 4), by a need to ‘control’ corporations within a market economy. Works like those of Sprague (3.2) illustrated accounting interactions with the economic and social changes then occurring. Much time would elapse (and most efforts arguably for practitioners were a waste of time) before the development of the present definitions found under the CF projects (Chapter 7).

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Jackson (1956, p290) found, ‘The rules were clearly intended to cover all types of transactions which the young book-keeper might be expected to meet and comparable attempts to extend rules for this purpose are common until the end of the eighteenth century.’

255
As may be inferred from Kohler's conclusion above, during previous periods much has been written and debated about terminology with little resolution – arguably many issues being in principle irresolvable. As regards liabilities, agreement is still sought.\(^{738}\)

The practitioner wing of the profession, through the work of committees like May's (recall 5.2.2), adhered to a definition of accounting propounded in 1941 where stress was made of it being in broad terms.\(^{739}\) A technical\(^{740}\) meaning was followed, contrary to the AAA (1957, p60) claim that only limited financial expertise was required by non-accountants.\(^{741}\)

Others like Moonitz (1961, p23) suggested some narrowing in a definition\(^{742}\). Diversity of opinion continued. Hendriksen (1965, p2) stressed that an early step in the development of an accounting theory was a clear statement of the objectives of accounting. Note however the use of the term 'objective' (as adopted, for example, in AARF 1990a) – not, as Chambers (1976a) would argue, 'function'.\(^{743}\) In such a setting, debate seemed unresolvable.\(^{744}\) Chambers (1966a, p2) pinpointed a problem

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\(^{738}\) Agreement here would increase the likelihood of a set of interrelated elements emerging.

\(^{739}\) ATB No 1 (1953, p9) ‘rejected suggestions that the definition be made more explicit by mention of other details of accounting, because it questioned the desirability of writing its definition in terms which while perhaps sharpening its presentation, might also unduly limit its scope.’

\(^{740}\) Stans (1948a, p102) commented on the conflict/tension between the ‘skilled accountant’ and ‘the layperson’ when it came to reading financial statements prepared in accordance with ‘generally accepted practice’: ‘True, the skilled accountant who reads such statements may in no way be disturbed or confused by the things that confuse the layman. He will understand the variations of treatment permitted within the bounds of generally accepted practice, will understand the technically phrased terminology and, upon analysis, could well form an advised and sound opinion as to the significance of the information in the statement. By past standards, under which consistency is paramount and “general acceptance” the prime criterion of procedures, present income accounting practices are proper and justifiable. But many things that are “generally accepted” by accountants are not generally understood by the public. This fact alone gives biased critics their opportunity to becloud the presentations still further in insinuations of secret reserves, hidden profits, the availability of surplus. And so on.’

\(^{741}\) AAA (1957, p60), ‘... it should be possible for a person moderately experienced in business and finance to examine such statements with the expectation of deriving from them the basic facts on which at least tentative business judgments may be premised.’

\(^{742}\) Moonitz (1961, p23), ‘The function of accounting is (1) to measure the resources held by specific entities; (2) to reflect the claims against the interests in those entities; (3) to measure the changes in those resources, claims, and interests; (4) to assign the changes to specifiable periods of time; and (5) to express the foregoing in terms of money as a common denominator.’

\(^{743}\) Even if agreement was found here, Hendriksen (1965, p2) continued, ‘Once the objectives of accounting are established, one or more of several approaches to accounting theory must be selected in order to derive logically conceived accounting principles.’

\(^{744}\) In 1950, a study of terminology was begun in Australia. An interim report was published in 1953 in *The Australian Accountant*, but no final report eventuated (Zeff, 1973, p33).
as being a preoccupation with issues of application at the expense of an understanding of the underlying reasoning.\textsuperscript{745}

In defining ‘liability’, the official AICPA approach was to be within the context of a balance sheet, resulting in a most technical definition.\textsuperscript{746} It supported various items (arguably strange to the layperson) appearing as liabilities in balance sheets (Staunton, 1974).

Chambers’ definition (1966a, p 120) was, in contrast, narrow and precise,

\textit{Liabilities are rights of creditors to the satisfaction of claims against the assets of an entity in priority to the residual equity.}

To some, his definition was a departure from conventional accounting. It also tended to take a legal approach (Kerr, 1984, p15-16).

Definitions of liabilities would be extended to include not only legal obligations but also equitable and constructive ones (FASB, 1985, Footnote 22). Mixed were legal, financial, social and economic ideas.\textsuperscript{747} Tensions necessarily followed.

\textsuperscript{745} Chambers (1966a, p2), ‘What is generally understood by the study of accounting is the study of accounting methods and rules. That a knowledge of methods and rules is useful is obvious. But statements of methods and rules are not statements about accounting. They are part of accounting as it is practiced or as it is recommended to be practiced. As such, they give no understanding of the nature and function of accounting. We may acquire skills by learning the rules, but skills without understanding are potentially dangerous. Unless we understand the nature and function of accounting, we have no basis on which to decide whether any rule or rules will be consistent with its capacities and its function.’

\textsuperscript{746} ATB No 1 (1953, p13-14), ‘27.... in relation to a balance sheet, liability may be defined as follows: Something represented by a credit balance that is or would be properly carried forward upon a closing of books of account according to the rules or principles of accounting, provided such credit balance is not in effect a negative balance applicable to an asset. Thus the work is used broadly to comprise not only items which constitute liabilities in the popular sense of debts or obligations (including provision for those that are unascertained), but also credit balances to be accounted for which do not involve the debtor and creditor relation. For example, capital stock and related or similar elements of proprietorship are balance-sheet liabilities in that they represent balances to be accounted for, though these are not liabilities in the ordinary sense of debts owed to legal creditors.

‘Consideration of the facts noted in the last sentence of this definition has led some accountants to the view that the aggregate of liabilities as contemplated in this definition should be referred to as the aggregate of liabilities and capital, and that the balance sheet consists of an asset section, a liability section, and a proprietary or capital section, with the monetary amounts represented by the first shown as equal to the sum of those represented by the other two. The committee feels that there is no inconsistency between this view and the suggested definition.’

\textsuperscript{747} FASAC (2004b, p10), ‘Paragraph 40 differentiates constructive and equitable obligations from what are termed “legally enforceable obligations” on the grounds that “they lack the legal sanction that characterizes most liabilities and may be binding primarily because of social or moral sanctions or custom.” Thus, legal obligations are equated with being legally enforceable. Equitable obligations are described as stemming from “ethical or moral constraints rather than from rules of common or statute law, that is, from a duty to another entity to do that which an ordinary conscience and sense of justice would deem fair, just, and right – to do what one ought to do rather than what one is legally obligated to do.” Constructive obligations are described as being “created, inferred, or constructed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government.”'
FASB (1976, para 149-181) provided a summary of conflicting views. The definition which followed (FASB, 1980, para 28) reads,

*Liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events.*

A similar definition was proposed in SAC 4 (AARF, 1992).\(^{748}\) Other than rewording, the major difference was the exclusion of the constraint 'probable'. Instead, this was transferred to the consideration of 'recognition'.

Research by Ijiri (1980) and Johnson and Storey (1982) saw the idea included in CFs (Chapter 7). It divorced a definition from what was to be incorporated in accounts and resulting financial statements. In Australia, SAC 4 included,

> 65 A liability should be recognised in the statement of financial position when and only when:

(a) it is probable that the future sacrifice of economic benefits will be required; and

(b) the amount of the liability can be measured reliably.

Criteria are required to analyse various definitions of, and applications afforded, the particular term 'liability' in accounting. Discussion as to whether or not definitions (and recognition) are 'good', 'bad', 'right' or 'useful' require those criteria to be established. Otherwise, the debate remains unresolvable, as argued in Chapter 7, especially as regards the different interpretations of 'probable' (FASAC, 2004b, p3-6).\(^{749}\) Recognition also had implications for measurement and the term 'value'.

8.3 The uses of the term 'value'
The reasoning here (and followed by Chambers in developing CoCoA) involves words or similar symbols (single or in groupings) and processes (logic, grammar and the like) to develop and test hypotheses for internal consistency and external verity (recall Chapter 1). Demski (2002, p1) argues that this type of research is a legitimate approach and that academic accountants 'do not well appreciate the complementarities among our various activities.' In modern academic business schools, Chambers' way of reasoning was questioned by some, but Demski supported the role of that reasoning.\(^{750}\) Certainly to argue against Chambers' approach dismisses celebrated thinkers since the days of Plato or Aristotle.

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\(^{748}\) AARF (1992), '48 "Liabilities" are the future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events.' Various bodies like FASAC (2004b, p3 & p14) have similar intent.

\(^{749}\) Particular writings might be analysed for example in terms of (1) the viewpoint taken on a precise identification of the function of accounting which places further propositions in context; (2) the internal consistency of reasoning using the term liability and related terms (such as 'obligation' or 'debt'); (3) the approach taken to valuation.

\(^{750}\) Demski (2002, p1) continues, 'To illustrate, contrast two classroom approaches to dealing with some financial reporting issue ... One approach might emphasize the informational efficiency of globalized security markets, while another might emphasize the importance of cognitive framing and concatenating the accounting with various non-accounting information sources. (One could just as easily place this juxtaposition in a research project setting.) Two facts strike me as important here. First, neither approach is completely factual; rather, each emphasizes particular aspects of the larger puzzle. Each, therefore, has an error term. Second, the Blackwell Theorem teaches us to be wary of
Crosby (1997, p13) points out ‘Aristole, “the Philosopher,” as medieval Europe called him, found description and analysis more useful in qualitative terms than in quantitative ones.’ Aristotle (Thomson et al, 1976) wrote of a series of ‘virtues’ or ‘values’ as shown in Figure 8.1. There, the values are classified into Intellectual and Moral. The former were Science (which includes issues of knowledge), Techne (which includes technical skill and issues of competence or resourcefulness) and Wisdom (which includes intelligence and understanding). The latter were Courage (which includes loyalty), Temperance (including generosity and magnanimity) and Justice (which includes discipline). The keystone to integrate the values into a coherent framework is that of Prudence (which includes acquired practical wisdom).

**Figure 8.1 Aristotle’s Virtues/Values**

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<th>'Virtues/Values'</th>
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<tr>
<td>Intellectual</td>
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This framework did not incorporate measurement *per se*. At the other extreme, more modern thought introduced numbers/measurement into reasoning and research methods, perhaps to a premier level.

Reference by Knight (1955a, p162) to economists and philosophers provides a context for this term in its most broad level. Perry (1954, p2-3) argues that the term over-reaching preference statements in this type of setting. To claim that one approach is generically better than the other is logically equivalent to making the claim that the errors in the second can be modelled as if they were equal in distribution to the errors of the first plus an addition of gratuitous errors. I sincerely doubt this is the case. This means the two approaches offer the prospect of teaching us more about the underlying puzzle than either one by itself. Complementarities are present.

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751 Crosby (1997, p12), ‘The writings of Plato and Aristotle celebrate an un-, an almost antimetrological approach and have the further advantage of being representative of our ancestral mode of thought at its best. These two men thought more highly of human reason than we do, but they did not believe our five senses capable of accurate measurement of nature.’

752 Bensusan-Butt (1978, pp 178-179) argues, ‘The pursuit of rigour in theory – in itself, the worthy aim of getting the logic watertight – requires mathematics. The prestige of mathematics (a language opaque to most of the population) has led to the now almost universal practice of stating theoretical arguments in this symbolic form. It is in a form distant indeed from the part verbal part-pictographic, part-emotional language in which agents in fact conduct their making of decisions.’
can have meaning for any object of interest. However, the quantification of that term led to debate. For instance, Knight (p163) took issue with Perry’s discussion of the quantification of ‘truth’ or ‘beauty’. Stevens (1946, p677) had discussed similar issues in the context of the ‘measurement’ of human sensation.\textsuperscript{754}

In developing CoCoA, Chambers would emphasise the use of ‘price’, it being a narrower concept than the broader ‘value’. In debates, this point was often not appreciated, as others would introduce the use of say ‘market value’. To Chambers, this would be too inexact.\textsuperscript{755} His CoCoA would be based in principle on exit market prices. As will be shown later, Chambers was required to debate various related issues.

As met in earlier chapters, the reporting of ‘values’ in some quantified way has been over time a major dilemma for accountants. It was often in the context of CG and the statement of financial position to be prepared and communicated to other stakeholders. Recall the debate between May and Ripley – the former and his conventional accounting and the latter and his reporting of ‘current value’.

Peloubet (1935, p201) argued that ‘value’ being a subjective idea, the basis of value is what a person or group of persons thinks. Here he is certainly writing as a philosopher – Aristotle might easily agree. Peloubet (p205) also made a point with which supporters of CoCoA would agree, suggesting a search into the meaning of value led to the conclusion that ‘value’ is an opinion and little else.\textsuperscript{756} He was prepared to admit that this might be more important than facts, but a distinction was necessary between ‘value’ and ‘facts’.\textsuperscript{757} While his interpretation of ‘facts’ is debatable, this distinction is a key idea in CoCoA.

\textsuperscript{753} Knight, (1955a, p162), ‘Economists and philosophers or workers in some branches of each field talk much among “value”, in theory and application.’

\textsuperscript{754} Stevens (1946, p677), ‘Deliberation led only to disagreement, mainly about what is meant by measurement. An interim report in 1938 found one member complaining that his colleagues “came out by the same door as they went in,” and in order to have another try at agreement, the committee begged to be continued for another year.’ The final report in 1940 dealt in some detail with the Sone scale of loudness.

\textsuperscript{755} Staubus (1977, p129), ‘The first issue to be considered … is terminological. Is “measurement” the appropriate term for use in accounting or would “valuation,” or perhaps “quantification,” serve better? “Valuation” has been used extensively in the accounting profession.’

\textsuperscript{756} Editorial (1935a, p83), ‘It will be a little difficult to accustom investors to the absence of the precious word “value”. It is a kind of fetish which has been overworked by economists and schoolmen generally, who have sought by the use of a simple, common word to afford a method of interpreting financial statements. We congratulate the Commission on its wisdom.’

\textsuperscript{757} Dewey (1939, p1-2), ‘Perhaps it is safest to begin by asking how it is that the problem of valuation-theory [appears] so largely in recent discussions…. Since the propositions of the natural sciences concern matters-of-fact and the relations between them, and since such propositions constitute the subject matter acknowledged to possess pre-eminent scientific standing, the question inevitably arises whether scientific propositions about the direction of human conduct, about any situation into which the idea of should enters, are possible; and, if so, of what sort they are and the grounds upon which they rest.’
Chambers (1966a) argued decisions were based on relationships between ‘values’ and ‘exit prices’ where if
- values exceeded Exit price, one would hold,
- values were less than Exit price, one would sell,
- values equalled Exit price, one was indifferent.

Sterling (1979) made similar decision-rules a key part of his argument for exit-price accounting. He (1979, p63) proposed a highly specialised hypothesis regarding the calculation of depreciation. His claim of it being ‘rather feeble’ is not so if debates were to be resolved. He emphasises two related criteria (p65):
- empirical testability, and
- relevance.

After discussing depreciation under conventional accounting, Sterling (p67-70) concludes ‘they present problems that are in principle unresolvable’. Instead, he suggests ‘a measurable attribute’ (p70-75) as reflected in exit market prices – the basis for CoCoA. He also meets various objections raised by opponents of the use of those prices. He then discusses ‘the proffered hypothesis’ (p75-80) which is testable.

The criterion ‘empirical testability’ is similar to ‘rules of correspondence’ (Margenau, 1976) which may be either verbal or mathematical. Financial accounting by definition uses numbers – what is known as a numerical relationship system (NRS) – in particular, dollars. The role of non-financial numbers in reporting as pointed out earlier, results in the use of ‘numbers’ in say social/environmental accounting or behavioural accounting.

Sterling builds on his ‘relevance test’ (p 81) identified earlier (p65). What is required is a measurable attribute – one that is empirically testable. He produces (p82-84) arguments about the measurement of particular attributes. In USA, debate centred on
- historical cost,
- price-level adjusted historical costs, and
- replacement costs.

After defining ‘relevance’ (p84-85), he introduces various ‘decision models’ (p85-91). He finally suggests (p91-93) certain issues which makes the use of selected measures (including the three above) irrelevant to the reporting of contemporary financial position where exit prices are preferred.758

However, reports using exit prices were not readily accepted in practice. Peloubet (1935, p206) argued against the practice of revaluation from ‘cost’ (to a figure possibly price based).759 He (p209) did, however, reveal the potential use of prices (as opposed to values).760

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758 Sterling’s ‘hage’ calculation (p 92) is used to show the futility of conventional accounting reports.

759 Peloubet (1935, p206), ‘There is, I think, no accepted practice or principle which requires periodical revaluations; and revaluations made infrequently, either reducing or increasing cost, while permitted in some circumstances, are an exception to the usual rule. The Securities and Exchange
The argument had reached a level summarised in Figure 8.2. Selected values could be quantified, some in monetary terms and others under a rating or ranking scale. Some of the monetary types were in terms of prices, others price-based but incorporating conventional accounting ideas and some price-based but incorporating future events.

**Figure 8.2 Values and Prices**

VALUES

- **NON-QUANTIFIED**
  - NON-MONETARY
  - PRICE-BASED
    - CONVENTIONAL
    - FUTURE

- **QUANTIFIED**
  - MONETARY

The balance sheet under conventional accounting continues to be questioned as inadequate, providing serviceable information for varied uses only by chance. James (2003, p138) suggests that the 'balance sheet has been in trouble for at least a decade.' Under conventional accounting, the treatment of intangible assets in the balance sheet was becoming less descriptive of how business is actually carried out.

Having instanced the dot-com boom and debates on 'true value' in those companies, James debated (as did Stevens (1946) and his committee in the 1930s) whether some 'quality' might be possibly quantified. Within these 'intangibles', James lists intention to defraud, fraud itself, greed, honesty, integrity, intuition about the market, empathy with customers and staff, insight into investors and the ability to make difficult decisions. In a related development, McCrossan (2005, p2) argues for ideas from behavioural economics to be considered. Here, the behaviour of

- bank depositors,
- residential mortgage holders,

Commission apparently does not think it would be of any service to stockholders, investors or the public to attempt periodic revaluation.

Peloubet (1935, p209), 'Any accountant who attempts to make valuations other than those indicated by the accounts or by some definite index, such as a market price, is coming dangerously close to the boundary of his own field and is preparing to step over into that of the economist and engineer. Valuation in any true or important sense is not a matter for the accountant and the more completely this is recognized by accountant and client the better it will be for all concerned.'

262
• life insurance policyholders,
• holders of workers' compensation, unemployment insurance, or long term disability income replacement polices, and
• policyholders who purchase a segregated fund (p4-6),
provide a valuable economic resource for particular financial intermediaries.

These are illustrated by the ‘demand deposit floor’ found in a bank (McCrossan, 2005, p10-11). While contractually deposits from customers are payable on demand, the ‘value’ of the liability is debatable. Given that the deposits’ turnover is often slow and time to maturity long, Peasnell (2005, p9) argues that for the liability, ‘the fair value estimates arrived at might be substantially lower than the amount repayable to the depositors.’ Barth (2005, p7-8) makes a similar point. This is linked to a ‘deposit premium’/‘demand deposit floor’ type intangible.761

Indeed, interactions of new developments with accounting led to tensions in the information to be provided. As Peasnell (2005, p9) points out, ‘valuation and risk management of [selected] liabilities involves complex issues in practice.’ They in turn lead to seemingly irresolvable debates in underlying reasoning, especially as regards measurement.

8.4 The valuation methods/measurement
The quantification/measurement in accounting (and resulting reports) had to deal with issues faced in other disciplines, including that of the measurement discipline in general. Analyses have of course been carried out independent of practice for several centuries.762

Tools for measurement would see their use as the rules of correspondence in theory development. A number system was used to reflect the phenomena of interest - measurement thus introduced.

8.4.1 In general
Sterling (1970, pp 65-66) warns, ‘Anyone who expects to find a single, well-established definition of measurement is due for a disappointment’. Reasons for disappointment are clearly tied up with the historical development of measurement which Stevens (1975) traced. As is often the case, measurement was practiced for some time before it was deemed necessary to analyse what was done. Early practice

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761 Peasnell (2005, p9) sees this as ‘obtained by the bank as reward for the services provided to depositors and as such is a form of prepaid income. There is no market for such deposit premiums and any attempt to fair value must involve consideration of entity-specific factors.’

762 Ritchie (1923, p3) has written of early Grecian times, ‘Mathematics, they thought was an occupation for gentlemen, but using tools or working with your hands “simply wasn’t done”. It is perhaps hardly sufficiently realized how important a part the mechanical parts play in the development of science and how absolutely essential they are for the purpose of physical measurement.’ Crosby (1997, Abstract), 'The Measure of Reality discusses the epochal shift from qualitative to quantitative perception in Western Europe during the late Middle Ages and Renaissance. This shift made modern science, technology, business practice, and bureaucracy possible. It affected not only the obvious – such as measurements of time and space and mathematical technique – but, equally and simultaneously, music and painting, thus proving that the shift was even more profound than once thought.’

263
dealt with counting or tallying of objects – a concept which is termed **numerosity**. In olden times (and possibly today in primitive society), counting in practice was simply ‘one, two, many’. However, in any accounting, it increasingly involved larger numbers (Sy & Tinker, 2006, p109).

Once analysis began, the number system became an abstract system in its own right. To enable discussion and appreciation of various ideas necessitated a frame of reference. Finkelstein (1975) provides a suitable one. He employs the reasoning used by Suppes and Zinnes (1963) to explain the elements:

- a set of empirical relationships in a real world/P-field/ERS
- a set of numerical relations in an abstraction/C-field/NRS
- a mapping.

Given such a frame of reference, ideas on measurement were incorporated into research carried out in both the hard and soft sciences (Cooper & Schindler, 2001; Kerlinger, 1986), consistent with the development of various schools of thought.

From the NRS, the use of numbers was classified into two schools. The differences between these two schools centre on two disputes,

- whether or not it is necessary, to be called a measurement discipline, for the relationship in the NRS to be capable of replication in the ERS, and
- the role of properties/attributes of phenomena reality/P-field/ERS.

In the second dispute, philosophical questions are found, such as what reality is and whether phenomena in reality could exist independent of being experienced by man. Supporters of the narrow school argue that the object or phenomenon of interest must possess a certain pre-existing property or attribute which can be measured. Broad school supporters on the other hand, continue to emphasis the well-defined operational procedures whereby numbers are assigned.

The broad school has various supporters in conventional accounting who stress the various operational procedures. ATB1 (1953, p 8) saw little difficulty arising from the

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763 Finkelstein (1975, p104) writes of Q being a well-defined, non-empty set of phenomena. Within this class there exists a set of empirical relations, representing the Empirical Relational System (ERS). N is a set of numbers on which are imposed a set of numerical relations, representing the Numerical Relational System (NRS). M is a mapping of the ERS by the NRS on a one-to-one basis (i.e. an isomorphic mapping exists) or on a many-to-one basis (i.e. a homomorphic mapping exists). The triplet equal to (Q, N, M) then constitutes a scale of measurement of Q. M is required to be a well-defined operational procedure. Margenau (1976) used P-field and C-field for ERS and NRS respectively.

764 Such a classification was made by Stevens (1959, p 19) writing: ‘Perhaps it is unfair to pretend that this liberal and open-handed definition of measurement is the accepted norm, for some practitioners of the physical sciences prefer to cling to the narrower view that only certain of the tidier rules are admissible.’ Abdel-Magid (1979) refers to the narrower view as the ‘classical’ school.

765 Refer Sterling (1970, p66-67). Abdel-Magid (1979, p348-351) also refers to significant differences between the two theories.

766 Sterling (1970, p 67) writes that some argue ‘that to attribute pre-existing properties to objects commits one to an untenable metaphysical position’.
'procedures' used, even though criticisms continued. Perhaps 'procedures' did not have the same meaning as would be offered by those in the measurement literature proper.

Concerning the first dispute on the requirement for physical operations to show 'additivity', Stevens (1975) refers to a twisting of original ideas on 'measurement'. He attributes it to Helmholtz in 1887.

Those in the narrow school emphasise a distinction between fundamental and derived measurements. The former is restricted to those cases where the additivity axioms in the NRS can be replicated in a physical sense among the phenomena in the ERS. When such direct measurement is not possible, indirect operational procedures lead to a derived measurement.

The fundamental-derived classification added little to the resolution of debates in accounting. However, the narrow-broad one continued to be debated. Those in the broad school emphasise the various scales of measurement. Nominal, ordinal, interval and ratio scales are identified which Stevens discussed over time.

The ideas underlying these various scales can be classified in various ways. Stevens (1946, Table 1, p 678) arranges them in terms of Basic Empirical Operations, Mathematical Group Structure and Permissible Statistics. Suppes and Zinnes (1963, p42) developed certain axioms of measurement of extensive properties. Hempel (1951, p56-66) develops a similar set of axioms. Cohen and Nagel (1960, p39-40) develop Formal Conditions for Measurement. It is unnecessary to analyse these discussions here. It is sufficient to note that Cohen and Nagel state six conditions.

The first two are sufficient if measurement is restricted to non-additive properties (such as beauty or intelligence). However, all six conditions must be satisfied if measurement in a narrow sense is to be possible.

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767 ATB1 (1953, p 8), '... it is a universally accepted practice to add the cost value of one asset to the market value of another, and to deduct from the sum the amount of a liability to arrive at a net figure. This procedure, although open to obvious criticism of its mathematical propriety, possesses so many practical advantages and is so well established that it is not likely to be abandoned.'

768 Stevens (1975, p45) suggests Helmholtz '... turned the matter around ... and implied that unless the concrete operations could be mirrored by the mathematical laws of additivity, the operations did not qualify as measurement.'

769 Stevens (1959, p 22) writes, 'Only a few properties such as length, weight, and electric resistance, are measurable in this fundamental way. Most other magnitudes dealt with in physics are measured by indirect or 'derived' measurement - a process in which derived magnitudes are defined by means of numerical laws relating fundamental magnitudes. Thus density, the classical example, is measured by the ratio of mass to volume.'

770 Compare for example, his 1946 discussion, especially Table 1 (page 678) and his 1959 discussion, especially Table 1 (p 25).

771 The conditions are, 1. Given a set of bodies B1, B2, B3 etc, one and only one of the following relations holds: B1>B2, B1<B2, B1=B2; 2. If B1>B2 and B2>B3, then B1>B3; 3. If B1+B2=B3, then B2+B1=B3; 4. If B1=B2, then B1+B4=B2; 5. If B1=B2 and B3=B4, then B1+B3=B2+B4; 6. (B1+B2)+B3=B1+(B2+B3).
Some writers think dispute over nominal scales is not vital. It is, Stevens (1959, p25) suggests, a problem of words.\(^7\) A similar argument applies to ordinal scales in certain circumstances.\(^3\) Here, however, Cohen and Nagel (1960, p40) point out that results of ‘measuring’ may be overstated or misinterpreted.\(^4\)

The case where all six conditions have been shown to hold introduces the problem where the narrow school argues that ‘additivity’ must be possible in a physical sense if there is to be fundamental measurement. Stevens (1946, p680) suggests this to be a non-problem, as addition in the physical sense was unnecessary in various instances of ‘measuring’.\(^5\) His argument has important implications for measurement in the social sciences (including accounting). There, the debate moved to the type of ‘measuring that was going on’ and how it was to be incorporated, suggesting a range of measurements from soft to hard type.

Larson (1967, p 484) makes the case that, despite an incapability of addition in physical terms, the assignment of numbers to allow quantities to be related in a ratio fashion provides various benefits.\(^6\) The substantial benefits will depend on the particular field of study. Acceptance of particular measurement practices has greatly changed since the times of major debate as to what was ‘measurement’. Stevens’ (1946, p680) reference to ‘the assignment of numerals to things so as to represent facts and conventions about them’ as ‘the most liberal and useful definition of

\(^7\) Stevens (1959, p 25), ‘I would merely point out that the oft-debated question whether the process of classification underlying the nominal scale constitutes measurement is one of those semantic issues that depends upon taste.’

\(^3\) See for instance Vickrey’s (1970, p 737) discussion of quasi-series.

\(^4\) Cohen and Nagel (1960, p 40), ‘When only the first two conditions are satisfied, it is nonsense to make statements which imply that all six have been shown to hold’.

\(^5\) Stevens (1946, p 680), ‘... this important empirical fact is generally accorded more prominence in the theory of measurement than it deserves. The so-called fundamental scales are important instances of ratio scales, but they are only instances. As a matter of fact, it can be demonstrated that the fundamental scales could be set up even if the physical operation of addition were ruled out as impossible of performance. Given three balances, for example, each having the proper constitution, a set of standard weights could be manufactured without it ever being necessary to place two weights in the same scale pan at the same time. The procedure is too long to describe in these pages, but its feasibility is mentioned here simply to suggest that physical addition, even though it is sometimes possible, is not necessarily the basis of all measurement. Too much measuring goes on where resort can never be had to the process of laying things end-to-end or piling them up in a heap.’

\(^6\) Larson (1967, p484), ‘A wide variety of scientific investigations are concerned with properties that are essentially incapable of being subjected to empirical operations that would prove their additivity. Nevertheless, many of these investigations can be substantially benefited if quantities of the properties can be assigned numbers so that the quantities can be related in ratio fashion. Further, any investigations are relatively uninterested in the possibility or validity of performing such operations as addition. It was in response to this need that Stevens attempted to develop measurement procedures that would allow ratio comparisons but would not depend on empirical operations designed to prove the additivity of the property.’

266
measurement' gave full rein to the use of numbers in cases far removed from the narrow definition adopted in the physical sciences.

The 'rules of measurement' developed in various disciplines (including accounting) saw the idea of data being classified over a range from 'hard' to 'soft'. The range of the applications of numbers via measurement certainly grew in the non-hard sciences. Bodies like the OECD and the World Bank measure concepts like CG or institutional quality of governance and seek correlations with say economic growth. This is consistent with suggested ideas of what to include in economic or social reports (Appendix IV).

Another general problem concerns the matter of accuracy of measurements. Chambers (1965, p45) warned that even in the so-called exact sciences, a presumption of complete accuracy is false. The degree of accuracy is a function of

- quality of instruments,
- precision of instruments, and
- practical purposes.777

His argument can be reconciled with the ideas discussed in debate of the meaning of the phrase 'scientific method'. In terms of concepts, the theory established is some ideal. However, the rules of correspondence in such an ideal theory are not necessarily any particular measurement in a specific case.778 This point is well made by Churchman (1959, p92) when he simply states, 'Accuracy is itself a measurement'.

A series of problems may be met if the requirement of addition in the physical sense is ignored. Various writers have referred to the danger of exclusive concentration on the NRS.779 The mathematical characteristics of the number system have in-built qualities. Use of such a NRS does not necessarily correspond to phenomena in the ERS. As will be argued later, it is this empirical correspondence that has been and may still be questioned in reports of a conventional accounting or selected financial type.

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777 Chambers (1965, p45), 'But the challenge of accuracy may be taken up more directly. Those who raise this objection appear generally to have in mind the type of accuracy they imagine the so-called exact sciences to possess. The presumption that the exact sciences provide measurements which are paragons of accuracy is false.... Even the exact sciences are not concerned with accuracy as an absolute. They are concerned with degrees of accuracy, and the degree of accuracy is always a function of the quality and precision of the instruments (including the hand, the eye and the brain) used ... Not only that; the degree of accuracy sought is the degree necessary for practical purposes.'

778 See Margenau (1976, p3), '[T]he price of a commodity which enters into economic theory is not the bargain price one happened to pay in a particular purchase.'

779 Cohen and Nagel (1960, p87) for instance, argue, 'We must be on guard against a common error. It is often believed that because we can assign numbers to different degrees of a quality, the different degrees always bear to each other the same ratio as do the numbers we have assigned to them. This is a serious mistake, and arises because it is supposed that measurement requires nothing more than the assigning of numbers.'
In summary, it may be stated that emphasis is placed, with some caution, on what can be done with numbers once they have been generated. The focus is on the properties possessed by various mathematical group structures associated with various scales.

8.4.2 In accounting

Some saw measurement in accounting as part of the 'terminology and standardisation' problem. However, the conventional accounting approach to measurement (ATB1, 1953, p8) undoubtedly followed (at best) the broad school. No 'property' of either asset or liability is mentioned and the question of additivity in the empirical relational sense is ignored. However, the phrase 'obvious criticism' (of its mathematical propriety) suggested some doubt among members of the committee as to whether 'measurement' is found. However, the reference to 'procedure' and the claim that this is 'universally accepted' is consistent with certain proposals in the broad school.

Just where the procedures followed by accountants are to be found in any range of measurements is a matter of conjecture. For instance, Churchman (1971, p30) has commented on the ability of protagonists of various, opposite sides in debates to assign numbers when questions of social change are of concern. He for one would place procedures followed by accountants more towards unacceptable within the range.

Various writers have, over the years, referred to 'measurement'. In the 1920-1930s, Sweeney (1964 reprint) published his ideas towards a rigorous theory of accounting. Included is a chapter Where Ordinary Accounting always goes wrong, (p1-23). One part is headed Ordinary Accounting Procedure is Mathematically Unsound (p 7). Sweeney (p 9) argued, 'The mathematician would put it this way: The rules of arithmetic are the rules for the manipulation of numbers when related to a collection of homogenous objects.' Obviously, the phenomena in accounting either were not agreed upon or were not able to be thought about as a homogenous group.

Boulding (1962, p54) concluded of accounting, 'A hundred feet plus ten centimetres is certainly not a hundred and ten anythings, and the accountant's balance sheet total is not much better.' Such matters remain unresolved.

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780 Bray (1949, p412), 'We must try to get our tools of measurement precise and as far as is reasonably possible universal. In this way we may elevate accounting to the plane of science.'

781 However, as Stevens (1946, p680) cautions: 'Measurement is never better than the empirical operations by which it is carried out, and operations range from bad to good. Any particular scale, sensory or physical, may be objected to on the grounds of bias, low precision, restricted generality, and other factors, but the objector should remember that these are relative and practical matters and that no scale used by mortals is perfectly free of their taint.'

782 Churchman (1971 p30), 'The facility is clearly a product of the history of enterprising accountants and economists, people who have spent their lives assigning numbers to social changes. So facile has the process become that so long as there is a hint of reasonableness, the numbers themselves carry the conviction of their accuracy.'

783 This point is made often and in various ways in the literature. See for instance Chambers (1973b, p20): 'The Report offers no comment on the aggregative nature of financial position; it contemplates adding what for all practical purposes (and for good theoretical reasons) cannot properly be added.'

784 Larson (1969, p39) writes: 'What are those 'things' accountants measure? A cursory answer may involve listing several items such as assets, equities, revenue, expenses, and income. Yet the
To provide a structure for potential resolution of various debates (including references to ‘equities’ and the concept ‘liability’), Chambers (1965, p 40) asked:

- What are the objects of these monetary calculations?
- What events and things are to be taken into account?

He relied upon ‘tradition’ to provide, in very general terms, answers to his questions. Accounting was concerned with,

- things and services traded in markets
- legal or equitable relationships among those acting in those markets.

However, accounting was not concerned with

- personal qualities of people
- things or services which were to be withheld from trade.785

Similar questions have been raised by other writers. Much of the debate (met in Chapters 5 & 6) began with the postulated primacy of the income calculation. Often, reference was made to ‘measurement.’ The argument here became whether ‘income’ was a fundamental measurement or a derived measurement. Some argued that income could be measured directly in terms of revenue and expenses. Others took the view that income could only be measured when derived from certain changes in the measures of assets and liabilities over time. Indeed, such an approach was eventually used in the CF projects (Chapter 7).

Debate has persisted for decades. Marple (1963) debated the inclusion of ‘values’ in financial statements while Bierman (1963, p501) saw the then interest in measurement as the start of ‘a long awaited revolution in accounting.’ However, he was shackled by conventional accounting and a related reference to different measurements being needed and used for different purposes.

785 Voluminous literature on the nature of these items suggest that they are, at best, only hazy notions of the “things” accountants measure.

786 Chambers (1965, p 40), ‘Accounting has traditionally concerned itself with things which are, or are capable of being, traded in markets and with the legal or equitable relationships between actors which arise from trading in markets. By market is meant any process by which goods or services are transferred from the control of one person or entity to the control of another. The limitation of objects of accounting to things which are capable of being traded in markets is important. Only insofar as rights or property are transferable is accounting concerned with them. The personal qualities of people are not so transferable; they cannot be served, nor can they therefore be subject to the monetary calculus. But the services arising from those qualities are transferable, and accounting can and does concern itself with such transfers. Similarly, no possession of an actor of which he has no intention of parting (trading) can usually be an object of accounting.’

786 Kelley (1948, p 148) for instance wrote, ‘The chief reason for the present-day disagreement in the measurement of income for a given period does not lie in the necessary use of subjective measurement for certain items of cost, but it does lie in the fact that the basic standards or principles, on which the very concept of income rests, are not agreed to or generally accepted.’ See also Mackenzie (1947) and Kelley (1951).
Chambers (1964) responded to this and various other ideas. He argued it to be a mere truism if it meant it was possible to measure different characteristics. For the proposal to be meaningful, he argued, it had to 'mean measurements with different degrees of accuracy for different purposes' (p 265). He suggested, however, that the proposal was used in the accounting literature in neither of these senses.

For measurement in accounting to be logically discussed, it must be seen as part of a wider topic. It must be reasoned about in the context of the ideas on theory construction for example. Here, Larson (1967, p 480) questioned whether the descriptive validity of accounting calculations could be established. His rather complex argument relates directly to the seeking of verification in the ERS. It does not follow that because ratio scales (with their inherent NRS qualities) are used, such use is empirically true.

Vickrey (1970, p 738) agreed, coining the phrase accounting quasi-measurements. Having identified several of these and compared them to measurements in the physical sciences, he concluded that conventional accounting calculations were merely quasi-measurements (see also Thomas, 1969, 1974). The next step is of course

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787 Including some proposed by Homburger (1961). Chambers argued (p5) that Homburger (1961) made a mistake similar to that of Bierman, as '... he shifts the term objective from its proper connection with the measure we seek to the character of the evidence on which the measure is to be based.' When Homburger (p97) speaks of measuring a particular kind of asset, Chambers replies, 'We do not ever measure objects; we measure properties of objects.'

788 The latter has been acknowledged in a commentary thus: 'Some ... controversies may stem from the fact that all measurement systems are subject to measurement error. In the process of measuring states and events, even when consistent definitions are used, it is entirely possible because of measurement error that balance sheet items and income statement items could be expressed in ways that are inconsistent.' (AAA, 1977, p 30).

789 See Stamp (1973, p 16) when he suggests that such a view is not always found: 'One suspects that the more conservative members of the Study Group were apprehensive about the objectivity of measurements of current value, and it is noteworthy that the Report is disappointingly inadequate in its discussion of the measurement problem. Indeed, one would have thought that measurement was one of the most important objectives of financial statements.'

790 Chambers (1964, p268-269) for instance refers to Margenau (1959) in his argument, 'It is the lack of "preformed theoretical constructs" which makes many allusions to measurement in accounting pointless. We may do either of two things it seems. We may forbear to speak of accounting as a measurement process. Or we must attempt to form some theoretical concepts of what is to be measured and what the significance of the obtained measure will be.' See also Chambers (1966a, p377-378), Index of Names, Margenau (sic). This is corrected in the 1974 Scholars reprint.

791 Larson (1967, p 480), 'Specifically, it is the problem of establishing the descriptive validity of accounting calculations. The primary objective is to show that descriptive validity must be verified by empirical operations and is not substantiated by the utilization of ratio scales in measurement or by the mathematical characteristics of the number system employed in accounting measurement.'

792 He (p738) considers assignment of historical cost to an asset, the determination of total assets, the calculation of the current ratio and of earnings per share and points out the parallels to measurements in the physical sciences.

793 Vickrey (1970, p738), 'Ultimately, the logic and usefulness of these measurements depend on the additivity of extensive properties.'
to identify how accounting could become something more than a discipline concerned with quasi-measurements. However, this in itself can present problems as will be shown below when accounting for liabilities is further examined.

In a way which reflected the thinking of the time, Larson (1967) pictured an empirical relationship directly from costs to reality, with a distinction between assets (A) and costs (C) in the NRS. He intended to ‘emphasise the necessity of isolating a particular property to be measured’ (p 483). However, the distinction between costs and assets within the model confuses the picture. What needs to be emphasised is that once a general concept (such as ‘means’) has been identified, then any attempt at measurement of some property of that concept (in this case, for example, by putting a ‘cost’ on it), automatically specifies that asset in the abstraction field. It would seem, then, that C1, C2, C3 should refer to properties of the concept of concern rather than concepts *per se* and that A1, A2, A3 should be ‘assets in accounting’.

Assets defined in terms of means having the property cost-in-$\$, have important implications in terms of theory construction. Both assets and liabilities in accounting have been discussed in the literature as posing distinct problems of:

- definition, and
- measurement.

It is clear from the above discussion that by conventional accounting dealing with ‘costs’, the measurement issue was inherently included. Ma and Miller (1978) faced a similar problem within a discounted-present value of cash-flows-approach. They differentiated between the concept and a measurement rule. Those who incorporated both simultaneously were ‘under a misapprehension.’ One did not identify an asset or a liability and then measure some property thereof. As met earlier, this thinking was adopted in CFs, along with a third idea of

- recognition.

Such identification would be in terms found in a Word Relational System (WRS). This more general idea is then narrowed by the use of ideas of measurement. Consider Cohen and Nagel (1960, p 34), ‘Both in daily life and in the sciences, however, it is often essential to replace propositions simply affirming or denying qualitative differences by propositions indicating in a more precise way the degree of such differences. It is essential to do so in the interest of accuracy of statement, as well as in the interest of discovering comprehensive principles in terms of which the subject matter can be conceived as systematically related.’

It is supposed here for purposes of the argument that ‘cost’ is a property. Note however, Vickrey’s warning, (1970, p 738, Footnote 20), ‘Of course, historical cost is not even a property in the same sense that mass, length and volume are properties of empirical phenomena.’

See for example Sprouse and Moonitz (1962), ‘Assets’ are discussed in Ch 3 and 4 and ‘Liabilities’ in Ch 5. Indeed, in early drafts on this topic, prevarication is evident. See Staunton (1975, p 17), ‘The inclusion of both identification and measurement is not intended to circumvent debate on the need for such a distinction.’

Ma and Miller (1978, p60), ‘Concept and measurement are two distinct and separate things …’

Ma and Miller (1978, p65), ‘We are grateful to Professor Ray Ball for clarifying this distinction between a present value concept and a present value measurement rule, and suggesting the use of the present value concept in our definition.’
In CoCoA, Chambers identified a general class (means for assets and obligations for liabilities). Ideas from measurement when applied, as rules of correspondence, to some property of certain items in these general classes, result in the identified asset or liability being measured.

However, measurement in CoCoA was criticised in Larson and Schattke's (1966) analysis. They confused 'additivity' in the measurement theory sense with 'combination' in the physical sense. In summary, they suggested Chambers' proposals were inadequate. Chambers responded (1967, p 755), suggesting that Larson and Schattke failed to appreciate 'the total scene' envisaged by his system of CoCoA.

However, overshadowing all such discussion is the implication that measurement ideas can be applied in accounting. As discussed earlier, Vickrey (1970) suggested that accountants performed quasi-measurements and that further research was needed before accounting could be classified as a measurement discipline. He argued that such a classification would follow the meeting of certain necessary and sufficient conditions:

- an assumption on what phenomena are to be represented,
- assignment of numbers to those phenomena,
- the identification of at least one extensive property held by those phenomena,
- the identified property is measurable in standard monetary units, and
- accountants accept that identified property.

The final point is of interest in that it suggests that 'acceptance' of an idea is an integral part of the establishing of a theory. However, identification of a property of the 'things' to be measured is needed. But whether or not that property is extensive needs to be established. Vickrey (1970, p 740) suggests such a property may be purchasing power, a concept he finds very similar to Chambers' current cash equivalent (CCE).

Indeed, one debate concerned questions of the 'additivity' of the property CCE proposed by Chambers (1966a). Trowell (1978) has described and analysed this debate at length. His (p86) findings included,

- confusion of measure theory and measurement theory,
- scant regard for the conditions of measurement, and
- confusion about additivity.

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799 See Vickery (1970, p 738, Footnote 19), 'A quasi-measurement is a process which bears only superficial resemblance to theoretically sound measurement procedures.'

800 Vickrey (1970, p738), 'Assuming accountants wish to represent economic facts about accounting entities by assigning monetary amounts to accounting phenomena and aggregating these amounts as they have done historically, accounting is a measurement discipline if and only if at least one extensive economic property is identified which (1) is possessed by accounting phenomena, (2) is measurable in standard monetary units, and (3) is accepted by accountants as appropriate for accounting measurement. If such an accounting property cannot be identified, we must conclude that accounting can never by classified as a measurement discipline in the strict sense.'

801 Trowell (1978, p86), 'The central issue of additivity was seen to be confused for a number of reasons. The lack of a clear distinction between measure theory and measurement theory was one. Another was a failure to consider the importance of the conditions of measurement. These matters
Accounting in general still lacked foundations as the ERS of accounting was not well-defined.

Trowell (1980) also analysed the *Numerosity paradox*. Vickrey (1975, p141) had examined Larson and Schattke's argument on the additivity of CCE where CCE is defined as numerosity. Vickrey rejected the argument of Larson and Schattke. However, he also questioned the additivity of CCE if defined in terms other than numerosity.

Both Larson and Schattke (1975) and Chambers (1976) responded to Vickrey's article. The former were generally non-committal. Chambers, however, sought to refute Vickrey's challenge. Again, Chambers stressed

- the need to appreciate the total scene encompassed by his proposals,
- the need to differentiate between a property and the measurement of that property,
- the idea of 'purchasing power', and
- numerosity and related implications.

Chambers suggested a failure on Vickrey's part to identify the particular level of abstraction with which he was concerned.

Abdel-Magid (1979) also took issue with Vickrey's arguments, including those in Vickery (1976). In general Abdel-Magid was supportive of the original Stevens' ideas. Implications were that 'the accounting operations of quantification should be analysed with a view toward finding a formal model that can make accounting numbers more specific' (p347).

Abdel-Magid reiterated these points elsewhere (1979a, p826). There, he pointed to difficulties found in interpreting the views of various writers in the accounting literature. Vickrey responded (1979) answering various points on a paragraph-by-paragraph basis. Again it seems that the argument was joined at cross-purposes by a failure to agree on what is accounting.

The period 1970-early 1980s – a time of high inflation – saw the introduction of exposure drafts which explored potential adoption of some form of current value accounting. The Sandilands Committee Report (1975) resulted in a move towards

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802 Others also fail to appreciate this point. Consider FASB (1976, p 204), 'Contemporary resale prices are considered by proponents to be the only measurable attribute for all assets that, when combined with monetary items, satisfies the rules of addition, subtraction, and relation. Strictly, this should read, the only measure of an attribute (property) of all assets ....'

803 Abdel-Magid (p347) argued, 'most important is the fact that the rules of mathematics are man made. Those rules can be altered and expanded to provide useful quantitative explanations of man’s empirical activity.'

804 Chambers (1976c, p1) found it an 'irritation for those who expected tight argument based on firm evidence, but found instead that the Report’s conclusions and recommendations rest largely on beliefs
CCA (Chambers, 1976c, p3; Walker & Jones, 2003, p356-357)\textsuperscript{805} and in Australia a provisional standard (SAP 1, 1983) issued. However, support was lacking, especially in the private sector.\textsuperscript{838}

Peasnell (2005, p10-11) sees the argument being mirrored by a current one concerning financial instruments (to be returned to later in this section).\textsuperscript{807} The recycling of ‘measurement’ issues continues.

Miller and Loftus (2000, p5) argue the reaction of standard-setters to the collapse of support for CCA was to appreciate ‘constituents would not tolerate revolutionary changes in accounting measurement’ – a view met in Chapter 7 in CF deliberations.\textsuperscript{808} Indeed, an incremental approach was seen as the better approach.

It seemed impossible to disagree with particular expressions of views, as the protagonists continued to argue from different bases of measurement. There remained (often implicit) foundations underlying their arguments (Chambers, 1976c, p32-39). Debate would continue via the CFs.

8.4.3 Conceptual framework developments
Blocks 7 and 8 of the Australian CF (Chapter 7) involved measurement.\textsuperscript{809} Implications followed for liabilities in general and under CoCoA. While CoCoA

and opinions.’ Indeed, Chambers (1975a) published his own Exposure Draft on the matter, over 3000 copies being distributed worldwide.

\textsuperscript{805} Pong & Whittington (1996) and Whittington (1998, p28) write of the failed CCA experiment in UK in the early 1980s, as met earlier in 6.2.2.

\textsuperscript{806} Walker & Jones (2003, p357), ‘SAP 1 remains in force, but was virtually ignored by the private sector. However, during the 1980s the application of full-scale accrual accounting to public trading enterprises and general government agencies saw SAP 1 “dusted off” and part of its contents utilized in guidelines for asset valuation issued by a committee established by the then Industry Commission, in terms of an agreement established between the Council of Australian Governments …’

\textsuperscript{807} Peasnell (2005, p10-11), ‘[I]n many ways, the debate at that time was a mirror image of the current one. The valuation aspect of the inflation accounting debate was concerned with how best to measure the non-financial assets held by industrial and commercial companies; the current debate is about the valuation of financial assets, particularly those of institutional institutions. A problem for non-financial enterprises is they have assets such as work in progress, specialized plant and equipment, and other assets that can only be realized by transformation into other saleable assets through the production process or when bundled up with other assets. Such assets have negligible separable realizable values. Chambers recommended that such assets be assigned a value of zero because that is their current market value. The current cost alternative that was actually adopted is an entity-specific valuation model.’

\textsuperscript{808} McCrossan (2005, p11) acknowledges its inclusion under behavioural economic theory may face the same reaction: ‘The liability for the deposit is fair valued based on behavioural economic theory. This would lead to earnings at the time the incremental deposit is made. However logical to do so, such a change in financial reporting treatment might seem to be too radical to implement before a sufficient period of field testing that demonstrates that the behavioural assumptions can be credibly validated over time.’

\textsuperscript{809} Greenwood (1981, p23-25), while discussing the CF (recall Chapter 7) raised issues of measurement, including CCA and CoCoA.
presented a major change to conventional accounting, it also had to compete with other systems of change. The situation is summarised in Figure 8.3. The cost-based methods are better described by Sterling (1979) as Conventionally Allocated Past Purchase Prices (p141-144) and Conventionally Allocated Current Purchase Prices (p144-146). The allocations can be made initially (to calculate the cost of say an asset constructed by the entity) and over time (to allow for conventional depreciation).

**Figure 8.3**

Valuation Methods

- Cost based
  - Historical cost
  - Current cost
- Market based
  - Entry price
  - Exit price
- Future flows/discounted present value based
  - HCA
  - CCA
  - CoCoA
  - Deprival Value

The market-based methods are either an entry price or an exit price. Depending on the strength of the market, it is possible to argue that exit prices can vary as to the reliability of the measure. The same can be argued for entry prices. However, little work has been published on a pure entry price; instead, entry prices are included in the discussion of other models like CCA.

The various methods are consistent with the various models/theories debated in the literature. These are labelled HCA (or historical cost accounting), CCA (or current cost accounting) and CoCoA (or continuously contemporary accounting). Whether

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810 Peasnell (2005, p10), ‘The relative merits of current cost versus exit value were extensively debated in the 1970s. This was in no small measure because the late Professor Raymond Chambers vigorously (and almost single-handedly) promoted the case for exit values in numerous articles and books.’ Given the extensive work of Sterling, for example, the case here is arguably overstated.

811 In debates concerning cost-based methods, unforeseen consequences saw problems which tended to compound. Beard (1946, p7) provides an insight: ‘It has been said, even with justification, that military men generally base the beginning of every new war on the experiences of the last war rather than on an exploration of new potentials or on Napoleon’s maxim of “act and then see” (on s’engage et alors on voit).’ Rather than introducing new ideas, practitioners of conventional accounting tended to build on previous errors.

812 Sterling (1979, p145) argued that, in the Anglo-Saxon literature, Revsine (1973) was one who worked on this model as a pure system.

813 Godfrey et al (2003, Ch 6, 7 & 8) provide excellent pedagogic discussion of these models and related issues.
or not the future flows/discounted present value (DPV) is a model in its own right is a
debate in itself. Canning (1929; 1929a) certainly discussed the method and Hansen
(1962) provided illustrations and argument. However, for the purpose is of this study,
DPV is accepted as a model supported by present practice and found in accounting
standards (West & Duggan, 1993; FASB, 2000).

The suggested use of deprival value calculations in the Anglo-Saxon literature (Dean,
1998) as a general prescriptive theory for asset and liability valuation is based on a
method suggested by Bonbright (1937). It led to ‘value to the owner’ and was
challenged by Chambers (1970a) as a use distinct from amounts for the determination
of contemporary financial position. Following comments from Wright (1971),
Chambers (1971a, p65; 1976c, p40-42) tightened his argument against its use. A form
of deprival value received support in the UK and by sections of the profession,
especially in the valuation of infrastructure assets (Clarke, 1998, p8; Walker et al,
2000; Walker & Jones, 2003, p357). Its results are very similar to CCA, but being a
hybrid system, it allows particular circumstances to determine the choice among
CCA, exit price and DPV for valuation purposes.

In the Australian CF project, Blocks 7 and 8 are termed ‘Basis of measurement’ and
‘Techniques of measurement’ respectively. Work on the SACs for these blocks
seemed to hit a major hurdle in the early 1990s. However a major boost was received
with the publication of AARF’s ATM 10 (1998). Here, the Relative Current Value
Model (RCVM) is the preferred approach. RCVM has several perceived advantages
over the present practices found in financial reporting:

- it takes into account any changes in the monetary unit used in the
  measurement of the property of the asset (and/or liability),
- changes in the market values of assets (and liabilities) are recognised as they
  occur, and
- a comprehensive statement of net profit in the statement of financial
  performance is adopted.

The first and third perceived advantages do not affect the valuation debate directly but
have consequences for profit determination and its reporting. The inclusion of
changes in the value of the unit of measurement allows resolution of the capital
maintenance dilemma (Chambers, 1978). The second advantage has a direct input for
the valuation debate. The suggestions found in the model are summarised in Figure
8.4.

The ATM 10 preference is for a market-based method. However, a pure exit price
model is not adopted. Instead, a net realisable value is to be used - an exit price less
particular expected costs (of say disposal). This is consistent with the practice found
in accounting standards. These ‘expected costs’ introduce a soft element into the

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in accounting standards. These ‘expected costs’ introduce a soft element into the

814 Mattessich (1998, p4) makes the interesting point that deprival value ‘is a kind of opportunity cost
approach for financial statement presentation.’ Ideas of ‘opportunity’ cost or value play a major role in
economic analysis, arguably suggesting deprival value is better placed in economic rather than
financial statements.

815 AASB 1037 (1998) for instance includes (para10.1), ‘net market value means the amount which
could be expected to be received from the disposal of an asset … after deducting costs expected to be
incurred in realising the proceeds of such a disposal.’
measurement. Further, in the no-market case the asset is shown not at zero, but rather proxies are allowed. The proxies are of course based on the three models met earlier.

**Figure 8.4**

```
Market based
  /-----
 /     
|
Market ---|---|---
  /     
Net Realisable Value
  /     
Exit price

No Market
  /-----
 /     
|
Proxies
  /     
Historical cost
  /     
CCA
  /     
Discounted present value
```

While deprival value is discussed in the monograph proper, (see paras 3.29–3.33), no direct reference is found in the concluding comments. However, the possible use of various proxies when no market is found means that the particular circumstances may allow, in effect, a choice among HCA, CCA or DPV, with consequences for the reporting of performance.\(^{816}\)

The valuation of assets and liabilities under RCVM, in principle on a market-based approach, simply rearranges the methods presently found in practice. As these methods include cost-based ones, so-called hard numbers of accounting remain rather soft.

The concluding comments in the monograph (para 15.2) include the case where the future economic benefits resulting from outlays are not capitalised, but recognised as expenses immediately. It is pointed out that this problem arises under all models that seek future economic benefits to be measured reliably in order to be recognised as assets. As data here are not (except via footnotes) included in financial statements, especially under conventional accounting, a distinct supplementary **table** or **report**\(^{817}\) is required, an idea returned to in Chapter 9.

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\(^{816}\) Craswell (1978, p 85), ‘These valuation bases cannot be used indiscriminately or interchangeably because ... each gives rise to a different concept of income...’

\(^{817}\) AARF (1998, para 15.3) suggests this problem may be overcome It is suggested (para 5.3) that this problem can be overcome ‘by including a table in the financial reports showing outlays on various categories of intangible future economic benefits which have been recognised immediately as an expense over the past, say, five years. This would enable users to assess the extent to which the profits have been affected by increases or decreases in such outlays.’
In USA CF developments, FASB (1984) produced a statement on measurement which included the usual ideas from the literature, much to the annoyance of Chambers (1998, p36). The AAA also had published over the decades, as met in Chapters 4-6, works on 'measurement'. Chambers (p36) writes of a critique in 1972 of the then more immediate ASOBAT (AAA, 1966, recall 6.2.1) and an AAA Committee Report (1971). Comments from referees (some of which seem most venomous) saw his paper rejected, but his critique and related comments were later resurrected (1998, p37-47).

AAA (1971) had questioned the then measurement processes under conventional accounting, especially in the context of developments in other disciplines. Foundations of accounting measurement were developed from economics and administrative behaviour which in turn had emerged from physics. However, while issues like the scope of accounting (p10-12), decision-making and decision-useful information (p12-16) and those of measurement in general (p20-22) were introduced, others were consistent with a recycling of ideas from conventional accounting. In discussing

- retrospective,
- contemporary, and
- prospective

measures (p26-30), illustrations of 'costs' and their various allocation methods were used. As well, the idea of a 'future prospective measure' produced dilemmas for the committee at both the underlying premises and the application levels.

To Chambers (1998, p37, presentation altered), 'rejection of the critique

- forestalled open debate,
- reinforced the use of guesswork magnitudes (e.g., discounted net cash flows) in accounts of the past,

818 Chambers (1998, p36), 'But time after time the task has been shirked – to where one of the latest major exercises simply averred that five different valuation bases (called “attributes”) are used in present practice, and their use was expected to continue (FASB, 1994/5, p. 151).'

819 A logical inference made by Chambers (p36) was they came from a member of the Committee, which was chaired by Ijiri. Other members were Mattessich, Rappaport, Summers and Thomas. While Thomas over the years had a close academic relationship with Chambers, others were not seen as supporters of Chambers' writings. For instance, Mattessich's views ranged from initial agreement with Chambers' argument (USA 202, Box 1, #246) through disappointment (Box 27, #8987) to more personal-type comments (Box 15, #6256). Various debates with, and criticisms of, Chambers' writings appear in Mattessich (1995a, p73, p140, p190-196).

820 AAA (1971, p48), 'The ideal would be to express the foundations of accounting measurement in terms of economics and administrative behavior, to express the foundations of the latter in terms of psychology and sociology, the foundations of these again in terms of biology, then in terms of chemistry, and finally in terms of physics.'

821 AAA (1971, p30), 'None of this, however, necessarily means that the accountant must himself develop prospective measures. The accountant could instead restrict himself to providing contemporary measures out of which his readers could develop prospective measures themselves. Indeed, if the accountant is unclear as to what kinds of future measures are desired by his readers, this may be the most appropriate policy for him to follow.'
• fostered the erroneous addition of past, present and future magnitudes,
• set a pattern of disregard for the far more disciplined examination of measurement to be found in other fields, and
• did nothing by way of reducing the diversity of valuation rules tolerated in present thought and practice.'

To him, the work of the AAA and the FASB continued to recycle issues. This seems consistent with Barth's (2005, p1) argument, building on the work of FASB, that estimation in financial statements is so common that the question is not 'whether' but 'how'.

Walker & Jones (2003, p359-360) also remain most critical of the work and the attributes to be measured. Further, they show concern that the work done to date under the Australian CF may be disregarded by either the FASB or the International CFs. For instance, the attributes of assets and liabilities to be measured (Barth, 2005, p4) are listed in Figure 8.5. All the usual suspects are listed, but the argument (p4-5) is against 'multiple measurement attributes'. Instead, 'fair value' is preferred.

This is consistent with the revisiting of the FASB's CF project (FASAC, 2004a). This will certainly recycle old and perhaps raise new tensions, including,

• the definition of liability,
• the effect of conditions, contingencies or other uncertainties,
• accounting for contractual obligations, and
• accounting for financial instruments (2004a, p13; 2004b; 2004c, p6-7).

Figure 8.5

Attributes of assets and liabilities

<table>
<thead>
<tr>
<th>HC</th>
<th>Modified HC</th>
<th>Fair value</th>
<th>Entity-specific value</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPV</td>
<td>Exit</td>
<td></td>
<td></td>
</tr>
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</table>

At the underlying reasoning level, issues of definition, recognition and measurement need consideration. At the application level, particular liabilities (contingencies, 822 Barth (2005, p1), 'Almost all amounts recognized in financial statements today reflect some estimates of the future. Assets and liabilities, by definition, embody expected future inflows and outflows of economic benefits. Most measures of assets and liabilities incorporate estimates of the future. Thus, the question is not whether today's financial statements should reflect estimates of the future. Rather, it is how they should.'

823 Walker & Jones (2003, p359-360), 'The FASB effort is more notable for the way it has avoided rather than addressed issues concerning accounting measurement.... It is tempting to observe that comments ... would be regarded as laughable in other disciplines, or even to the man in the street if the subject matter was more readily understood than accounting.... 'How shall this be described? An avoidance of intellectual engagement? A stunning abdication of responsibility? The effective abandonment of the CF project? Or just the only outcome that could be expected from a deadlocked or unadventurous board?'
contractual items and financial instruments) still seem beyond an early resolution stage. Analysis of financial instruments shows why.

These of course have existed as long as traders have had contractual dealings. Some are described as ‘primary’ while others are called ‘derivatives’ (AASB 1033, para 8.1.4). As shown in earlier chapters, even primary items like the liability ‘bonds’ presented apparently irresolvable problems of measurement under conventional accounting and of definition, especially under models like CCA.

Issues of definition are recycled in the classification of so-called ‘perpetual financial instruments’ (FASB, 2005a) which did not meet direct ownership requirements to be classified as equity. Two opposing views underlying debate were termed ‘Pure Ownership’ and ‘Extended Ownership’. The former was supported by a minority of FASB members whose argument was built around the primacy of direct ownership criteria. The latter, supported by the majority, was built around perpetual instruments:

- not embodying obligations for the firm, and
- lacking a settlement requirement

thus not meeting requirements necessary to meet the definition of a liability. Indeed, some claimed this was classification by default, though a case is made that it is an economic rather than a legal issue. Similarities are found between the legal or economic thrust of accounting met in the consolidation debate of the 1920s (4.2.1). Indeed, little seems to have been achieved since Clancy (1978, p176) found a lack of consensus in the literature on the definition of convertible debt.

The issues overlapped with the classification of ‘indirect ownership instruments’ (FASB, 2005b). To be classified as equity, indexation and settlement with a direct ownership instrument is required. If not, classification as a liability follows.

Problems were compounded when trading was extended to that in futures (in the early days this dealt with commodities like pepper - Vallance, 1955). These were solved by disclosure in Notes to the Accounts, although a variety of methods remained possible.

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824 AASB 1033, para 8.1, ‘financial instrument means any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.’

825 Stephens (1971) reviewed the literature and changes in the regulations on the valuation of convertible bonds. While primarily concerned with establishing the related cost thereof, he (p57) did highlight the issues of arguing by similarities (among various types of bonds - the substance type argument) which did differ from the legal approach. He (1971, p57) concluded, ‘Legally, convertible bonds represent debts of the corporation as long as the bonds are outstanding.’

826 Member Schipper (FASB, 2005a, para 7) argues that a broader idea like ‘equity’ rather than the narrower idea of ‘ownership’ is the determining factor and the decision is not classification by default.

827 Clancy (1978, p177, emphasis added) concluded an agreed definition required consideration of ‘(1) To what extent should the inseparability of the conversion feature influence the definition? Should the inseparability be viewed as a strict legalism that has no economic meaning or is the inseparability fundamental to the meaning? (2) Can convertible debt be placed in either of the categories of debt and equity? The definition of convertible debt as debt or equity implies that the security can fit as a subcategory within the concept of debt or the concept of equity. (3) To what extent should the market price of common stock influence or define the nature of convertible debt?’
(Staunton, 1974a). However, derivatives and their reporting turned out to be most troublesome.

The use is now of financial instruments (like futures, forwards and forward rate agreements, swaps and options in the interest rate, foreign exchange, commodity and equity markets) by the economic entity for trading activities, for compensation of employees and in the management of existing assets and liabilities (Macquarie Bank, 2003, p12).

With the deregulation-of-markets movement of the 1980s and developments in tax-effect finance, the reporting of complex derivatives\textsuperscript{828} posed problems for accounting (Bradbury, 2003, p388-389; Chalmers & Godfrey, 2000, p40; Hampton, 1996; Hancock, 1996). These are well highlighted in Australia during the privatisation of electricity suppliers and what Knight (2005, p3) has termed 'the heated debate surrounding hedge accounting.' Included in the privatisation was the Loy Yang A case.\textsuperscript{829} In the original sale of the formerly government-owned utility, a most complex financial structure, including derivatives, was used. While tax advantages were to be considerable, the application of such 'financial engineering' provided tensions in reporting and related interpretation, even by other professional investment advisors.\textsuperscript{830} Horton & Maceve (2000, p26-27) suggest problems faced by standard-setters (JWG, 2000) include conceptual and application difficulties,\textsuperscript{831} basically from interpretations of 'fair value'.

Clarke (1998, p9) has traced the idea of 'fair value' to at least the 1920s and the post-WWI social and economic conditions (recall 4.2). Then, a 'fair value rate base' was sought in times of hyper-inflation and potential social discontent. This base was, as

\textsuperscript{828} Peasnell (2005, p2), 'The latest serious challenge to the traditional accounting model has come from a different quarter. The massive changes that have occurred in the world's financial markets in recent years have been accompanied by innovation in financial products on an unprecedented scale. Derivative securities have transformed the risk management activities of financial institutions and major companies in ways that were unimaginable a couple of decades ago.'

\textsuperscript{829} Clegg (2003, p22), 'The 2000 megawatt power station in the Latrobe Valley, Victoria's largest single source of electricity supply, is an enormous Gordian knot that many have tried to unravel - and so far failed,... In the past few years, 12 contenders have stepped up and conducted due diligence in a bid to understand how to undo the tightly woven corporate and financial structures entangling the prized asset.

\textsuperscript{830} Clegg (2003, p22), 'In the words of one party close to the sales process, Macquarie pulled out "every trick in the book" when the original funding package was implemented. 'The results were multilayered debt instruments, and a web of derivatives sitting behind an opaque hedging structure. Loy Yang's financial structure is less comprehensible than the Balkan political landscape since the fall of Byzantine Constantinople in 1453. 'Although the Australian Taxation Office was the intended loser, the financial engineering is coming back to haunt them all.'

\textsuperscript{831} Horton & Maceve (2000, p27), '... the current IASC/JWG/FASB approach to accounting for financial instruments based on their interpretation of "fair value" is, conceptually, fundamentally flawed, and therefore unworkable in practice.... [T]he IASC (in company with other standard-setters) needs to reintegrate its approach to financial instruments with the "deprival value" theory set out in the AARF's ... ATM 10 ...'
Clarke points out, 'neither factual nor entirely conjectural.' This leads to the interesting suggestion of 'artificial markets'\(^832\) in which models are used to set 'prices'.

Models based on numerical data are not of course a recent development. In Chapter 2, it was pointed out that Pacioli's treatise was part of an arithmetic text. In Chapter 3, it was pointed out that Dickinson was a member of the actuarial professional group while Finney (1919) wrote of actuarial interactions. In Chapter 4, it was pointed out that parts of Canning's works were similarly oriented.

Extended use of models is found in the literature generally (Burke, 1984, p48)\(^833\) and selected professional approved accounting standards have recourse to models with discounting elements (Clarke \textit{et al}, 2003). Without doubt, forecasting and model-building were seen as key parts of reporting for decision-making, thus being consistent with Chambers' "total scene".

Amounts obtained via models were suggested as surrogates for amounts found in financial position statements (Craswell, 1978, p84).\(^834\) As well, Staubus (1985, p74) suggested a role for 'market simulation' in cases where current market prices were absent, especially as regards issues of application.\(^835\) He sought to incorporate those applications found in practice - his 'induced' approach - which included anticipatory data. This was inconsistent with Chambers' argument for the contemporary financial position of an entity under his preferred CoCoA.\(^836\)

Complex economic models were developed to frame and monitor policies and related forecasts by governments. These policies and forecasts were in turn used by business

\(^832\) Wearing (1993, p186) refers to 'a "synthetic" or "artificial" market which the company can use to its advantage' within a context of debt-defeasance.

\(^833\) Burke's article was within the context of tender evaluation in the electricity generating industry. He also made more general points, including (p52), 'The method of forecasting can vary significantly and depending upon the situation could range from simple time series analysis to advanced causally based econometric models.... The best forecasting model is one where the sum of the cost of preparing the forecasts and the errors associated with it are minimal.'

\(^834\) Craswell (1978, p84), 'In order to ascertain whether a substitute can function in place of a principal, it is necessary to establish the role of the principal and determine the capacity of the surrogate to fulfil that role.' He (p86) does warn, however, 'To suggest, therefore, that historical cost, replacement cost, selling price and net present value may be used as surrogates for one another is to deny the different concepts and amounts of income.'

\(^835\) Staubus (1985, p74), 'The market simulation notion is not represented as an excellent explanation of all accounting measurement practices. Current practice represents very crude market simulation accounting. The more important point is that the market simulation explanation fits present accounting measurement practices better than any other single explanation - better than historical cost, better than matching costs and revenues, better than exit values or current cost.'

\(^836\) Chambers (1969b, p364), 'We shall use "information" only of statements of matters of fact. It is not denied that in the course of reflecting upon past, present or future, one may make calculations employing at least some hypothetical magnitudes. But the results of those calculations can only properly be embodied in statements of the hypothetical or counterfactual kind .... Thus, hypothetical calculations and propositions provide part of the grounds for acting in one way or another.'
entities in their own planning and risk analyses and assessment (Murphy & Wallis, 1992). However, different assumptions led to variations in forecasts. Of concern was that these assumptions were to be made transparent. Debate continues (Haigh, 1994). Arguments range from economic modelling being a ‘capitalist conspiracy’ to particular applications like monetary amounts of employee entitlements and asset valuations under accounting standards (Walkley, 1992).

Models would be used in the application of fair value. Conceptual issues would be further debated regarding the links between fair value and deprival value which are on first sight quite strong. Bradbury (2000, p20) uses the concepts and relationships shown in Figure 8.6 to explain the scene.

As met in various debates covered in earlier sections, inconsistencies are found in terminology used. ‘Value-to-the-entity’ is used in a way which suggests it is the same as deprival value (Miller & Loftus, 2000, p9; Horton & Macve, 2000, p27; Peasnell, 2005, p6; van Zijl & Whittington, 2005, p6-7). ‘Fair value’ is ‘the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction’ (IAS 39, para8). From Figure 8.6, it may be inferred that ‘fair-value’ and ‘value-to-the-entity/deprival-value’ are the same.

![Figure 8.6 Relations between alternative measures of ‘Fair Value’](source: Bradbury, 2000, p20.)

However, disagreement did occur among standard-setters. While those in UK and IASC did accept the above case, in USA and Australia the link between fair-value and internal measure was not accepted (Miller & Loftus, 2000, p9), suggesting a break in the link above between ‘fair value’ and ‘internal measure. Indeed, in 1999 the FASB

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837 The differences might be classified as those about future national economic policies and international events, those about how the economy in theory works and those about judgemental adjustments regarding past errors or institutional changes.

838 Murphy & Wallis, (1992, p16), ‘But models cannot only be used, they can also be abused, and readers must be on the look-out for assumptions that have been swept under the carpet. When economists disagree, it is usually because they are making different assumptions. If the assumptions are not made explicit, and full information is not made public, sensible discussion cannot proceed.’
concluded that fair value (of financial instruments – some uncertainty appeared on whether this applied to all assets and liabilities) was the estimated market exit price. Chambers would agree as this differed from net realisable value. The latter includes future transactions costs which in principle introduce anticipatory items (AAA, 2005, p192).\textsuperscript{839}

More recently, FASB (2005) has further documented measures of ‘fair value’. It appears, like deprival value, to include all the valuation approaches met in Figures 8.4 and 8.6. Techniques to estimate fair value are to be consistent with the

- market approach,
- income approach, and
- cost (or asset-based) approach (para17).

Within those constraints, a hierarchy of preferences for measurement of fair value is developed (Landsman, 2005, p8-9). Level 1 refers to quoted prices of identical assets and liabilities from active trading. Level 2 refers to quoted market prices of similar assets and liabilities from active trading. Level 3 refers to company estimates.

Peasnell (2005, p5) suggests the development of a standard for financial instruments faces three concerns,

- fair value accounting introduces unacceptable measurement error,
- piecemeal modifications creates fresh problems, and
- fair-valuing liabilities is inherently unsound.\textsuperscript{840}

Interconnections among concerns and with other issues of liabilities are highlighted.

The fair value of liabilities, as shown earlier, was faced with the case in which there was no market from which an exit price could be determined. It was argued (Bradbury, 2000, p21; Bradbury, 2003, p391) that an estimate was required instead. Value-to-the-entity was seen for liabilities as a ‘relief value’. In order to apply various ideas, a replacement loan or settlement amount was introduced. In turn, settlement amount was seen as an exit value necessary to settle or arrange legal defeasance. However, consideration was also required of a value-in-use type calculation. The situation is summarised in Figure 8.7.

\textsuperscript{839} The Committee (AAA, 2005, p192) argues, ‘The most advantageous market is determined by comparing prices across multiple markets net of transactions costs. However, the ED requires that transactions costs be ignored subsequently in determining the fair value measurement. In our view, ignoring transactions costs is problematic because we believe such costs are an ordinary and predictable part of executing a transaction.’

\textsuperscript{840} Peasnell (2005, p5), ‘Three sorts of concerns lay at the heart of the problems the IASB has had in developing an acceptable accounting standard for financial instruments. One has been an underlying concern that fair value accounting will involve the introduction of unacceptable measurement error into accounting. Another has been that piecemeal modification of accounting produces a mixed attribute model that creates fresh problems. The third is that fair valuing liabilities is inherently unsound because it can involve the recognition of gain as the entity’s credit-worthiness declines. The three concerns are interconnected, in that tradeoffs are involved.’
Such a mixed measurement system certainly produces some disquiet. Peasnell (2005, p6-10) discusses issues met in fair-valuing liabilities. One is that the liability 'mirrors' an asset of another entity. Another is potential mismatch within an entity from different approaches to asset and liability valuation under conventional accounting. Issues of hedging and marking-to-market are raised. A third is the influence of credit risk which may lead to a modification of the carrying value of a liability. Distinct levels of abstraction are involved and issues still unresolved, as highlighted by the extract from Botosan et al. (2005, p159-169) met in 1.4.

As regards the specification of monetary amounts, a hierarchy has been suggested in the professional standard-setting literature:

- items traded in a ready, liquid market – for example listed corporate debt,
- items valued under sophisticated valuation models based on market inputs – for example, employee stock options, and
- items valued on models based wholly on management projections – for example Enron’s financial instruments (FASB, 2004, para13-23).

As regards the last suggestion, Clarke et al. (2003, p260-262) have incorporated it into measurement debates used (and abused) in the Enron case.

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841 Miller & Loftus (2000, p16), 'Undoubtedly, we have a mixed measurement system. But its extension is limited by the imperfections and incompleteness in markets and the intolerance of the constituents of standard-setting boards for sharp change, especially when there is a strong perception that capital market participants have a primary focus on measures of performance. Ironically, there is much less sensitivity about current values in the balance sheet than about the consequences of the resultant valuation adjustments for performance measurement.'

842 Peasnell (2005, p8), 'Nevertheless, it is easy to see that regulators could be disturbed by the possibility of failing banks appearing to have vanishing liabilities simply because the claims the represent are worth less in the marketplace.'

843 Chambers was not impressed with some models, writing (1974b, p135), 'I suspect, therefore, that any attempt to refine by statistical manipulation the process of discovering a reliable value will merely give a pseudo-scientific result, based at least as much on the assumptions of the refiners as on the raw data. Whatever doubt the user may have of the reliability of a reported value may be stilled; but he may nevertheless be the unwitting victim of the refiner’s imagination and technique.'
It is pointed out (p260) that Enron diversified their energy trading into trading in non-related commodities (including weather derivatives). As well, management bent group accounting rules on the ownership level so that losses could be hidden in Special Purpose Entities which were not to be consolidated. As well, they could be used to move selected debt off-balance (p261-262).

Reported profits were ‘manufactured’ by the use of the ‘market-to-model’ technique whereby the model was used to value derivatives. The valuation of various contracts was difficult as no actual market price existed. A computer model was used to generate ‘prices’ – the mark-to-model technique\(^{845}\) (Fusaro & Miller, 2002, p34-35). It was too easy to manipulate various factor inputs.

The use of numbers from models has produced spectacular financial performance when dealing with financial instruments, as instanced by the hedge fund Long Term Capital Management (LTCM). Thomas (1999, p22) highlights there the role of privacy, lack of disclosure and a client’s placing almost complete trust in management.\(^{846}\) LTCM would finally come undone financially by two flaws,

- limitations in the original Black-Scholes equation, and
- the amount of leverage involved.

Certainly the ‘valuation’ of liabilities under secondary financial instruments (like derivatives) for financial position purposes remains most complex, issues seeming again to be of an unresolvable, recycling nature.

### 8.5 Chambers’ CoCoA and liabilities

In CoCoA, Chambers (1966a) in general supported contractual amount\(^{847}\) rather than market price for reprotecting liabilities. This position has been reinforced over the years (1970a, p50; 1974b, p132; 1978, p127 and 1980, p25, p32).

However, controversy arose when the consistency between the measurement of assets and liabilities of an entity was questioned by Hendriksen (1967) and Iselin (1968). Chambers (1968, p 247) questioned the level of abstraction in argument but did cede that his argument might have been betterphrased.\(^{848}\) A similar point (of whether the...

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\(^{844}\) Clarke et al. (2003, pxvii), ‘Mark-to-Model: A method of mark-to-market accounting used by Enron. The model was used by Enron, drawing on discounting procedures, to arrive at a “synthetic” market price for Enron’s asset holdings of energy (and other) derivatives.’

\(^{845}\) Some commentators would mistake the technique for that of the mark-to-market. See Fox (2003, p40-42, p127-128); McClean & Ekland (2003, p40, p322).

\(^{846}\) Thomas (1999, p23), ‘[F]or the first four years of its existence, the whole financial world looked on the whiz-kids at LTCM with the same awe medieval peasants had for alchemists – practitioners of weird science, turning base metals into gold. Mysterious men known as “quants” made computerised calculations, seeking out tiny but quantifiable discrepancies between the prices of similar financial instruments.... The genius of the fund’s personnel was fabled.... Two of them, [Merton and Scholes], had just won the 1997 Nobel Prize for economic science.’

\(^{847}\) Gray (1975, p72), ‘Liabilities are recorded at face value being the legal obligations outstanding.’

\(^{848}\) Chambers (1970a, p50), ‘I may have confused the matter somewhat by reference to the discounting of payables on p.107 and by the implication of my recourse to the authority of Sprouse and Moonitz on
debate is one of definition or measurement) is made by Bradbury (2000, p19) who argues an underlying premise of ATM 10 is that liabilities are simply negative assets (recall Figure 3.2 on Sprague’s possible interrelationships).

Ma (1974, p126) argued for market prices for traded bonds and settlement/divesture amount for non-traded bonds. McKeown (1971), Sterling (1979) and Friedman (1978a) argued for market prices for all liabilities. The latter attempted to reconcile differences between Chambers and Sterling. Wearing (1993) examined the debate within the context of debt management, debt defeasance and the reporting of successes achieved by management.

However, Chambers continued to stress contractual amount for liabilities. The argument was based on

- equities not being negative assets so the same general rule need not be applied to both assets and equities,
- obligations being a constraint on action,
- his current cash equivalent/monetary equivalent being simply an idea unifying assets, liabilities and owners’ equity at one level of abstraction, and

p.196 for abandoning discounting for “roughly” matched short-term receivables and payables. These are mistakes, due, I imagine, to my difficulties in weaving my way among so many conflicting ideas. Discounting has a place in present value calculations. But it has no place in my notion of a dated financial position. The matter may also have been confused by my treatment of bonds as liabilities. For bonds held as assets I suggested market price; but for bonds as liabilities I suggested their face value.... My defence is simply that, at a given time, the issuer owes the bondholders the contractual amount of the bonds, whatever the price at which the bonds are traded.'

Ma (1974, p126), ‘Where the bonds are traded on the market, the appropriate measure of their current cash equivalent is the market price. Where the bonds are not traded on the open market, the appropriate measure of their current cash equivalent is the amount the creditors are prepared to accept in full settlement (which may be greater or less than the contractual amount, depending on whether the current interest rate on like securities is lower or higher than the bond coupon rate), or the amount the borrower has to offer a financial specialist to divest himself (the borrower) of the liability, whichever is the lower of the two amounts.’

Wearing (1993, p180-186) discussed Chambers’ arguments and concluded that Chambers’ critics place emphasis on economic arguments, including interest rate changes and related risk factor analyses.

Chambers (1970a, p50-51), ‘In short, equities are not just negative assets, and there is no reason that I can yet see why the same general rule should apply to both assets and equities.’ Chambers (1974b, p132), ‘But assets are not equities, and there is no ground for supposing that the same rules apply to both. The amount of the assets represents the claims of the firm, as against the rest of the community, to the use of resources. The amount of the liabilities represents the claims of the creditors against the assets of the firm. The claims of creditors against the assets of the firm do not become less (or the greater) as a consequence of transactions between bondholders.’

Chambers (1974b, p133), ‘In a nutshell, the possession of assets represents freedom to act; obligations to pay creditors are restraints on that freedom.’

Chambers (1974b, p132), ‘Ma contends that for publicly traded bonds “the appropriate measure of their current cash equivalent is the market price”. Although I introduced current cash equivalent when dealing with assets, I applied the term also to equities (p.107). If assets are worth in the aggregate $1,000 and the debts amount to $500, the residual equity in the assets is $500. Because the first is a money sum (the money equivalent of what is owned) and the second is a money sum, the difference is
• contractual amount, face value and market price of a bond being needed for choice or action, but only the first figure – contractual amount - would be included in the firm’s statement of financial position.\textsuperscript{854}

The argument remains consistent given Chambers’ premises. However, the argument seems to be about those premises. What would follow from the relaxation of say an ability to deal with the bonds shown as liabilities? Lipe (2002) analysed a case in which a company had potentially profited from its deteriorating credit rating.\textsuperscript{855} The argument implicitly supported Chambers’ argument for contractual amount being used.

Regarding measurement, two propositions are suggested:

• assets (market prices) less liabilities (contractual prices) equal residual equity (monetary amounts), and
• assets (market prices) divided by liabilities (contractual prices) equal solvency indicator.

The validity of these propositions was challenged as being heterogeneous by some. Recall the reference to ATB1 (1953) met earlier. Perhaps the debate was whether or not a measurable attribute must be specified or whether the measuring instruments have not yet been fully developed (Sterling, 1979, p 39). Chambers would continue to argue that liabilities be measured at contractual amount.

Staubus (2004, p261) summarizes (arguably with some poetic licence) Chambers’ approach to the measurement of liabilities as ‘current net settlement values’ (p269). Staubus and others would allow ‘use of a repertoire of measurement methods’ (p265).\textsuperscript{856} While in principle liabilities (and assets) were to be measured at exit price, surrogates were allowed in various cases (p268, p269-270).\textsuperscript{857} This is not consistent with Chambers’ CoCoA, as specified in his post-1966 clarifications (1970a; 1974b).

\textsuperscript{854} Chambers (1970a, p50) ‘The contractual amount of a bond at any time may be more or less than the face value, by virtue of redemption provisions in the bond indenture. It can readily be calculated from those provisions. But even if the market price is materially different from this contractual amount, the latter is the relevant figure for assessment of present financial position.... As long as the company’s affairs are reasonably secure, the bond price is a function of the coupon rate and the current market rate of interest. It has nothing to do directly with the equity of bondholders and others in the assets of the company. It is the quite separate function of the balance sheet to show just this.’

\textsuperscript{855} This issue is also referred to by Knight (2005, p3); Peasnell, (2005, p4-5); Andrews, (2005, p4). For issues regarding accounting and issues of credit risk, see Gebhardt (2005).

\textsuperscript{856} Staubus (1985, p61-63) listed the various measurement methods available under the then USA GAAP.

\textsuperscript{857} Staubus (2004, p271) does correctly state Chambers’ 1966 argument in which he allowed the use of surrogates. However, by the 1990s, Chambers had reversed that position (see for example Chambers, 1970a, 1974b).
8.6 Hierarchy of terms and their measurement

In the financial literature, analyses find a series of terms being used regarding liabilities, often with little explicit logical rigour. These include:

- claim
- debt
- liability
- obligation
- responsibility
- duty
- equity.

The terms per se may form a hierarchy whereby each is part of a subset of the following term. However, criteria are needed to distinguish among the terms. Some may be provided by the legal system which itself has distinct levels of action.

Staubus (1977, p188) found a hierarchy of measurement methods applicable to liabilities as they

may be ranked, on the relevance criterion, as follows:
1. Discounted future cash flows.
2. Future cash flows, if waiting period is short.
4. Negative NRV.
5. Replacement receipt (or proceeds).
6. Restated historical receipt (or proceeds).
7. Historical receipt (or proceeds).

Some years later, the IASB Framework (2003, para100, quotations regarding liabilities only) included under the bases of measurement,

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858 See for instance Dohr, (1941, p202, emphasis added), 'One of the basic purposes of the balance-sheet is to show the ability of the business enterprise to meet its current obligations as they come due. This is a matter of extreme importance, since the continuance of business depends upon a satisfactory working-capital situation. In addition, of course, it is important to indicate the long-term debt and its maturities.'

859 Boulton (1965, p1-2, emphasis added): 'It is an evident fact that commercial life consists of the making and fulfilling of contracts, using the word "contract" in its true sense as meaning any agreement designed to create obligations enforceable at law. Almost every act in business life creates legal rights and duties; the right to receive benefits, the duty to pay for them, the duty to supply goods or services, the right to be paid. As business goes on its accustomed way, the fact that it consists of this web of legal rights and duties may not occupy the forefront of our minds. Indeed, it is good that it should not, for it would be intolerable to live our business lives always thinking of the precise legal obligations which press upon us at every moment of the day, and worse to be engrossed always in the definition and exaction of our precisely determined rights. It is good that the necessarily rigid and narrow concept of legal rights and duties should be hidden from immediate view by the zest for activity, the stimulus of the rough and tumble of competition, and by the equivalent, in this machine age, of the joy a craftsman feels in achievement. But the fact of rights and duties is never very far away in the background. It is desirable, indeed imperative, that legal rights and duties should be always recognised as underlying the daily activity, underpinning and giving strength to the structure of business.' Similar comments appear in Hocker et al, (1990, p1-2).
(a) **Historical Cost**, Liabilities are recorded at the amount of proceeds received in exchange for the obligation, or in some circumstances (for example, income taxes), at the amounts of cash or cash equivalents expected to be paid to satisfy the liability in the normal course of business.

(b) **Current cost**, Liabilities are carried at the undiscounted amount of cash or cash equivalents that would be required to settle the obligation currently.

(c) **Realisable (settlement) value**, Liabilities are carried at their settlement values; that is, the undiscounted amounts of cash or cash equivalents expected to be paid to satisfy the liabilities in the normal course of business.

(d) **Present value**, Liabilities are carried at the present discounted value of the future net cash outflows that are expected to be required to settle the liabilities in the normal course of business.

The need for a hierarchy— including issues of both definition/recognition and measurement - superimposed within the type of information found in the reports suggested in Chapter 6, would provide the required rigour to account for liabilities. One is proposed in Chapter 9.

**8.7 Summary and conclusions**

In this chapter, issues of definition, recognition and measurement have been analysed. Various debates have been seen as in principle irresolvable. Reasons begin with disagreements on the definition of accounting and on the function of the related financial statements which in turn leads to disagreements on the definition, recognition and measurement of elements in those financial statements – one of which is, of course, ‘liability’.

**Argument**

8.11 **Tensions continue on the definition of accounting.**

8.12 **Tensions occur between GAAP and legal terminology.**

8.13 **Tensions were created by development of new items like derived financial instruments.**

CoCoA was not explicitly adopted in CFs, to the glee of some writers. Instead, changes to conventional accounting were stubbornly resisted, especially by practitioners.

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860 Stewart (1950, p301) discussed the classification of ‘deferred income’ and criteria to decide whether it was a liability or part of owners’ equity. ‘The legalistic concept of deferred income is at complete variance with what I consider to be sound accounting principles. The taxing authorities consider that advance commissions and fees are income of the year in which they are received, even though there is an obligation to refund part upon the happening of certain events that may occur in the future... I greatly prefer the employment of sound and generally accepted accounting principles over the use of tax decisions which are made only for the purpose of getting the money. If you have deferred income, show and call it that, with the exercise of care to determine whether or not it is deferred income instead of an actual liability.’

861 Stamp (1983, p119) claimed of CoCoA, ‘Yet, despite this profusion of argument, exhortation, polemic and, at times, invective, the response has been disappointing to Chambers and his followers. Many different proposals are being considered in various parts of the world for changes in the measurement basis used in published financial reports, but none of the exposure drafts or standards that have been used nominates CoCoA even as a secondary or supplementary system, let alone as a primary system of accounting to stand alongside or replace historical cost accounting.’ See also Gynther, (1972, p42).
Argument

8.21 Conventional accounting – May’s legacy – was still seen to have a function in CG. 862
8.22 The ‘total scene’ in choice was seldom introduced in debates on or criticisms of CoCoA.
8.23 At the application level, tensions arose which suggested a need for reports distinct from financial ones.

Tensions occurred in discussions on measurement in accounting in general.

Argument

8.31 By conventional accounting dealing with ‘costs’ and their allocation, 8.31 Tensions continue to occur in terminology used under GAAP in general.
8.32 By conventional accounting dealing with ‘costs’ and their allocation, measurement issues were inherently included in issue of identification or definition.
8.33 Attempts to include notions from measurement proper like
• the identification of a property debate or
• additivity in the physical sense debate
seemed to have
• little effect on applications by practitioners and
• an ability to derail proposals (like CoCoA) to change conventional accounting.
8.34 Various attempts were made to account using some form of ‘current value’, especially in times of high inflation.
8.35 Chambers’ CoCoA was seen as a radical change from conventional accounting.
8.36 Alternatives to conventional accounting measures (and CoCoA) included deprival value.
8.37 Alternatives to conventional accounting measures (and CoCoA) included fair value.
8.38 Debate was found on whether fair value differed from deprival value.

Tensions occurred in discussions on measurement of liabilities in particular.

8.41 Tensions continue to occur in terminology used under GAAP for liabilities in particular.
Conventional accounting still supported a carrying value which could be determined in various ways.
8.42 Chambers continued to support ‘contractual amount’ to determine the monetary amount of a liability.
8.43 Under CoCoA, face value, market trading price or discounted present value did not provide the monetary amount for financial position purposes; that was not to argue that these other values or prices were irrelevant in decision-making or choice.
8.44 Deprival value for liabilities was seen to encourage a mixed-value approach.
8.45 Debate was found on the application of fair value techniques.

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862 Consider Whitney’s (1940, p308) conclusion, ‘Traditional accounting procedures are sound, because accounts based on cost are easier to understand than accounts based on appraisals, and because they comply with the equitable doctrines governing reports of fiduciaries.’
In this chapter, findings of the continuation of past tensions and the recycling of issues without resolution suggest that, as regards the reporting of liabilities, lessons from history seem quickly forgotten. In the next chapter, current tensions are reviewed and ways in which they may be resolved suggested.
Chapter 9 Illumination – Reporting Liabilities in the 2000s: Progression or Regression?

What kind of view, then, may we have of the future? The wealth of nations, the living standards of us all, depend on the efficiency of business. And that depends on the prompt identification of potential sources of difficulty. It would, I imagine, be a ground for great professional satisfaction to be sure that accounting is playing its part in the pursuit of efficiency. But that is a satisfaction we yet have no right to claim.

Disciplined measurement of states and changes in state has been valued widely for the power it has given men over the variables that surround them and their enterprises.

Chambers, 1983, p469.

... the recent spate of accounting and corporate governance scandals has hammered home the message that incentive and transparency issues are just as important in this area of financial reporting as elsewhere.

Knight, 2005, p2.

Before, assets and liabilities were mostly carried at their historic, original cost; ‘fair value’ is an attempt to show their current worth. Fair-value numbers are up-to-date and arguably more relevant than their static but verifiable precursors. But they also result in more volatile profits and a heavier reliance on estimates for the many items (bank loans, buildings) that may not have a ready market.

The Economist, 2005a, p59.

9.1 Introduction

In Chapter 2, it was argued that until the mid-1800s, the corporation was primarily a legal institution – with a protection of investor thrust. ‘Investor’ was broad in its scope, covering shareholders and creditors. This thrust was to interact with accounting in general which had implications for the reporting of liabilities. The latter half of the 1800s saw a balance between legal and economic interests, again with implications for liabilities. The arrival of the large joint-stock corporation (increasingly in a holding-subsidiary corporate form) with a powerful management separated from ownership and backed by the financiers had seen the balance weigh towards economic interests.63

In Chapters 3 and 4, it was argued that in the 1900s, the corporation continued to be seen as an economic institution. Debates arose between economic and social issues, with the balance further tilting towards economic – especially regarding the role of the large corporation as ensconced in the pervasive phrase ‘big business’. The 1930s and the New Deal developments saw threats to big business,64 but their role in

63 McDonald (1962, p70-71) relates the story of the ‘Bryan panic’ which saw the powerful players in the USA money market do battle with the then Democratic presidential candidate, Bryan. The powerful players included entrepreneur Samuel Insull, whose actions and related interactions with accounting were met in Chapters 2 to 4.
industrial and service industries during WWII saw any threats minimised and the large corporation became well-established in society. The debates in turn again interacted with accounting with implications for the reporting of liabilities. However, the major interaction was certainly for reporting in general - the May Legacy of conventional accounting.

In Chapters 5 and 6, it was argued that the corporation was faced with various social issues which in some ways were to act as a counterbalance to economic issues. Indeed to some, the corporation had become a social institution. Again there were interactions with accounting with implications for the reporting of liabilities. There was criticism as conventional accounting was unable to meet the demands of various stakeholders. Some argued that the function of accounting required an expansion. Others, like Chambers, argued for a more rigorous and well-constrained one. Issues such as these were analysed in Chapters 7 and 8. It was argued that various issues were simply recycled with little regard for lessons to be learned from history.

As pointed out in 1.4, an unexpected coincidence, like those which affect various events in life and science (Hellman, 1998), occurred towards the end of the writing of this thesis. A most recent analysis of accounting for liabilities (Botosan et al, 2005) was built around the revisiting of the CF by the FASB/IASB (Chapters 7 and 8). The review of this analysis in 9.2 reveals a recycling of issues.

In this chapter, what is required to resolve tensions met regarding the reporting of liabilities (and thus break the recycling nature of previous debates) is examined (9.3). This is done in a manner consistent with the six Propositions (see 1.3) guiding this research. Initially, it is argued that a context is required, one which allows for a range of data to be presented (9.3.1). Next, the time factor is incorporated into the argument (9.3.2). Then the need for independent, but linked, CFs dealing with (at least) social, economic and financial matters is argued (9.3.3). A suggested hierarchy of terms on liabilities is provided to eliminate some terminological tensions which have characterized the recycling nature of some debates (9.3.4). The section concludes with a consideration of potential resolution of the measurement dilemma (9.3.5), where conclusions regarding the final two propositions are reached. These arguments have

864 The ability of management to manage and improve the presentation of corporate earnings continues to be highlighted in discussions of consequences from various recent scandals, failures and irregularities concerning accounting information (The Economist, 2005, 2005a).

865 Selected current research work suggests that to some these issues may overlap at various levels. For example, in the USA some economists write on social rather than monetary or financial behaviour (Levitt & Dubner, 2005). Papers and other information are available at the web address http://pricetheory.uchicago.edu/levitt/home.html.

866 This argument is supported by attempts to deal with the particular problem of liabilities faced under pension plans (both state and private) and the more general problem of ageing workforces. See The Economist (2006e, p11, emphasis added), 'The question of how to deal with the growing number of retired people has recently been seen as chiefly a financial puzzle: how to pay for the leisure of those ageing layabouts. When Bismarck first introduced state pensions in the 1880s, they kicked in at the age of 70, about 20 years more than the typical life span. Nowadays state and company pension schemes kick in at or before 65, almost 20 years less. But the issue is more than just a financial one: it raises social as well as economic questions, and its resolution will involve governments, employers and people.'
consequences for the annual report of a corporation which are then considered (9.4). Chambers’ vision and the future use of his CoCoA are then briefly discussed (9.5). Finally, a summary and conclusions are provided (9.6).

9.2 The analysis of Botosan et al (2005)
This article (Synopsis, p159) seeks to ‘highlight inconsistencies and controversies surrounding existing accounting standards for liabilities, and to describe the research evidence that provides insights into accounting for liabilities.’ It takes as a given the definition and characteristics as found in the FASB CF (Chapter 7).867

Issues of definition an/or recognition of liabilities in particular
From the given definition and characteristics, tensions are found in links to the next block of the CF – recognition. Specifically drawing on Botosan et al, these include,

- The meaning of ‘probable’,
  - does it have a technical or vernacular meaning?
  - is it interpreted differently among stakeholder groups like management, users or auditors?
  - is it interpreted differently within in each group?
  - how are changes in probability over time to be incorporated?868

Depending on the meaning adopted, inconsistencies arise regarding applications to ‘obligations’ for

- unvested employee benefits,
- asset retirements,
- guarantees,
- contracts with customers and
- transfers of shares as required in freestanding (like convertible bonds) or compound financing arrangements (including derivatives).

- The specification of an obligating event,
  - does an executory contract (like a long term building contract) meet selected criteria?
  - how are obligations from multi-events to be incorporated?
  - while legally enforceable obligations are seen to meet selected criteria, how are ‘equitable or constructive’ or other legally unenforceable ones to be incorporated?869

Depending on the interpretation adopted, inconsistencies arise regarding applications to ‘obligations’ for

- long term contracts,

867 As argued in earlier chapters and in 9.3, this ‘given’ may need to be challenged if recycling is to be prevented.

868 Research findings and future research possibilities are summarized by Botosan et al on p163 and p164 respectively.

869 Research findings and future research possibilities are summarized by Botosan et al on p165-166 and p166 respectively.
- executory contracts,
- lease contracts and
- pensions plans.

**A search for a classificatory scheme**

Tensions here have been compounded by the increasingly prevalent use of 'structured financing' (p168). Reasons for its use include,

- markets becoming more complete,
- stakeholders' increased ability to value and model complex financial instruments,
- an increase in the ability and need for firms to spread risk and
- management's desire to 'manage' a firm's tax, earnings using GAAP, leverage and regulatory capital (in the case of selected financial institutions).

Questions arose in a number of aspects, including,

- is 'equity' to be narrowly defined (as the most residual claims) and all other claims are 'liabilities'? 
- is 'equity' to be broadly defined to include any claim to be settled in shares?
- how is the ownership relationship criterion to be interpreted?
- how is the settlement obligation criterion to be interpreted?

Depending on the answers, inconsistencies arise regarding applications in which items are classified into equity or liability, with related implications for indicators developed from the position statement and the performance statement. It is suggested that 'trade-offs' are inevitable (p169) regarding the information sought among distinct user groups and within user groups. The identification of groups and subgroups is seen as a priority in order to develop a classificatory scheme.

**Issues of de-recognition of liabilities**

Tensions which arise here are closely linked to those met in previous sub-sections on definition/recognition and classification. Questions raised (p172, p175-176) include,

- does a legal approach lead to consistency in application?
- does a broader perspective based on risk analysis overcome inconsistencies in application?
- do financial liabilities and performance obligations require distinct de-recognition criteria?
- is a change in probability an issue of de-recognition or of measurement?

Note how various tensions are linked to (and arguably compound questions about) definition. There, once 'constructive and equitable obligations' were incorporated, problems arose on how to de-recognise them, especially in applications to 'liabilities' like guarantees or pension plan settlements (p174). As regards classification, if a

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870 Recall issues here have been considered decades earlier (McCoy, 1948; Melcher, 1973).

871 Research findings and future research possibilities are summarized by Botosan et al on p169-171 and p171 respectively.
A broad definition of equity is adopted, the in-substance defeasance of debt may lead to de-recognition of that liability.

A related issue on de-recognition of liabilities (p173) concerned whether a legal context or one in which an economic unit (or entity) of account held sway. Similar issues were debated in the 1920s regarding the reporting of consolidated groups' financial information (see 4.2.1). As regards liability de-recognition, the article simply concluded that the legal approach may be too limiting in selected areas, implicitly suggesting an economic approach.

Botosan et al argue (p175) that a liability with a probability of a claim reduced to zero may be measured at zero. However, it may not be technically de-recognized. No guidance is suggested as to application issues.872

**Issues of separability and measurement**

Discussion here deals with valuation tensions regarding ‘inseparable compound financing instruments’ (p177). It is argued that *simple* financial instruments may be typed as,

- explicit by contractual agreement or
- implicit by informal agreement,
  - intent, or
  - business purpose.

An attempt is then made to break down inseparable compound ones into components which correspond with simple financial instruments. Once done, joint values are allocated, a process which, it is agreed, ‘is inherently arbitrary’ (p178). Questions which arise include,

- is the decomposing of compound instruments into simple type components conceptually sound?
- is a preferable solution the separation of compound instruments into an equity and a liability component consistent with the earlier mentioned classificatory scheme?
- is a simple model with assumption about debt and equity components sufficient to allocate joint values?
- is a more complex model which uses assessed probabilities a preferred option?
- what is to be disclosed of assumptions underlying the allocation model?

Tensions remain for liabilities at the definition and measurement levels,873 which may need to be placed within a wider context.

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872 Research findings and future research possibilities are summarized by Botosan et al on p176-177 and p177 respectively.

873 Research findings and future research possibilities are summarized by Botosan et al on p181-182 and p182 respectively.
Questions like the above and analysis met in earlier Chapters suggest a degree of recycling of issues met in earlier chapters and that distinct levels of abstraction tend to be blurred. To break this cycle, a series of recommendations are now made:

- a contemporary statement of financial position is to be produced,
- tensions from a mixing of ideas and concepts of an interdisciplinary type are to be allowed for,
- an interrelated hierarchy is required in the definition of terms,
- acceptance is required that values are distinct from prices,
- dilemmas, met in measurement, related to the time factor, markets and models are to be considered, and
- consideration is to be given to Chambers’ ‘total scene’.

These points are consistent with the Arguments noted at the end of each Chapter and are now discussed along the lines of the Propositions met in Chapter 1.

9.3 The research propositions and requirements for resolving issues for reporting of liabilities
Each of the following items may be, and has been, debated in its own right. However, conclusions reached will have implications for other tensions. It is important, as noted in the analysis of CF projects (Chapter 7), to keep debates at the stated level of abstraction.

9.3.1 Proposition 1 and liabilities under conventional accounting
Unexpected, large corporate collapses\textsuperscript{874} continue, along with debate on the quality of accounting data\textsuperscript{875} and related accounting standards.\textsuperscript{876} The semi-professional literature (\textit{The Economist}, 2005) has raised questions of how to report selected liabilities. Of major concern are,

- derivatives like options and swaps,
- health care liabilities for retired employees, and
- employee stock options as a component of salaries.

Insofar as derivatives are secondary financial instruments the value of which is derived from an underlying primary instrument, accounting for them has certainly caused various tensions. Conventional accounting (with its historical cost bent) was unable to report them except as a note to the accounts.\textsuperscript{877} Health care accounting, including for liabilities, remains topical (Arnaboldi \& Lapsley, 2004; \textit{The Economist}, 2006b; 2006e), as do pension, superannuation fund accounting and related liabilities (Gallery \& Gallery, 2004; Parker, 2006; Moncrief, 2006). Finally, the reporting of the ‘cost’ of employee compensation (especially of top management) is under review by

\textsuperscript{874} \textit{The Economist} (2005a, p59), ‘A study by Glass Lewis, a research outfit, found that investors lost well over $900 billion in 30 big scams between 1997 and 2004.’

\textsuperscript{875} Clarke \textit{et al} (2003, p307), ‘Accounting data ought to satisfy the same general serviceability criterion of quality that applies elsewhere in the consumer society – that they must be fit for the uses ordinarily, knowingly and predictably made of them.’

\textsuperscript{876} Clarke \textit{et al} (2003, p307), ‘That entails abandoning those Accounting Standards not directed to marking-to-market the fungible assets, and stating other assets and liabilities at their face amounts.

\textsuperscript{877} Analysis of the Loy Yang case met in 8.4.3 illustrates tensions which arise.
standard-setters, among others (Walters, 2003; Waters, 2006; The Lex Column, 2006). Under conventional accounting (or Sterling’s Conventionally-allocated-past-purchase-prices, recall 8.4.3), a series of flexible, often subjective, guidelines remain, making it possible to continue to ‘manage’ the reporting of earnings. Doubt remains on whether resulting financial statements act as an effective CG control or provide information useful for decision-making.

9.3.2 Proposition 2 and the balance sheet versus financial position statement
The notion of financial condition/position was argued to be most important in questions of CG, but it provided tensions which, as demonstrated, were, arguably, in principle irresolvable. As shown in Chapter 4, the Terminology Department (1929, p52) hinted a statement of financial position was possible.\textsuperscript{878} However, whether a balance sheet provided a financial statement remained arguable. Others would suggest a title like ‘Statement of Investment’ (Stans, 1948a).\textsuperscript{879}

The official practitioner approach by the ATB No 1 (1953)\textsuperscript{880} continued to support the May Legacy, arguing a balance sheet was simply a list of historical balances of accounts - a technical accounting meaning.\textsuperscript{881} However, tensions arose with that

\textsuperscript{878} Terminology Department, (1929, p52), ‘Statement of Financial Condition: In accounting this is a statement of assets and liabilities, in which special attention is given to the relation of current assets to current liabilities.’ It should be recalled that reference to position/condition had long been a feature of legal judgments related to corporations. For instance, see Gower (1957, p109-113) regarding payments of dividends.

\textsuperscript{879} Stans (1948a, p105) wrote of the terminological problems met at various levels: ‘The subject of terminology likewise deserves prompt attention, courageous action, and sound conclusions having the force of rules. Much of the jargon of accounting is not wholly defensible under the attacks of those who characterize it is “technical gibberish” in a field in which laymen’s language could meet every situation. Efforts of corporations such as Caterpillar Tractor Company to find nontechnical expression prove that financial statements can be made understandable. ... Attacks have been made by many accountants on such terms as “balance-sheet,” and “reserve,” and “surplus” for many years but their background is so invested with tradition that it seems impossible to bring about changes. The fact is, however, that the problem of educating the public to the meaning and truth of published accounting statements would be greatly simplified if more meaningful terms were used. A balance-sheet could become a “statement of investment” and surplus could become “profits employed in the business” with complete and immediate understanding on the part of the uninitiated reader.’

\textsuperscript{880} ATB No 1 (1953), ‘21. In this view a balance sheet may be defined as: A tabular statement or summary of balances (debit and credit) carried forward after an actual or constructive closing of books of account kept according to principles of accounting...’

\textsuperscript{881} ATB No 1 (1953), ‘20. The terms balance sheet, assets, and liabilities are so closely related that the three can best be considered together. Indeed, the procedure is often adopted of first defining a balance sheet as a statement of assets and liabilities (or of assets, liabilities, and capital) and then undertaking the definition of assets and liabilities. This procedure, however, overlooks the fact that a balance sheet is historically a summary of balances prepared from books of account kept by double-entry methods, while a statement of assets and liabilities may be prepared for an organization for which no such books are kept; moreover such a summary may fall short of being an adequate statement of assets and liabilities. Since balance sheet is a distinctly technical accounting term while assets and liabilities are less so, the committee feels that balance sheet should be defined with reference to the origin (that is, the origin in the accounts) of its constituent parts, and that the relation of assets and liabilities to the concept of the balance sheet should be considered subsequently.’

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approach even within the practitioner wing (ATB No I, 1953). Over a decade later APB (1970) would suggest a balance sheet, when accompanied by notes to the accounts, would present the financial position of the entity.

As met earlier in discussion of the CF projects (Chapter 7), definitions of financial position juxtaposed the terms financial and economic (AARF, 1992). Tensions continue and debate remains unresolved.

9.3.3 Proposition 3 and interdisciplinary tensions
This provides a context for the resolution of selected tensions. The decision-useful idea for information is now well established, but elements there need to be strictly constrained. In Chambers’ CoCoA, he uses the idea of choice, where, as argued in 6.4.2, distinct levels are envisaged:

• economic behaviour,
• evaluation, and
• accounting.

Here, accounting was at the financial level as demonstrated in CoCoA. Others suggest a different interpretation, extending issues to at least the economic level.

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882 ATB No I (1953), ‘19. Since the committee’s mid-year report in 1941, and consistently with what was said in that report, there has been marked progress toward greater logic and usefulness in what nevertheless still are referred to as balance-sheet presentations. It may be that at some future date the term balance sheet will cease to be used to designate a presentation of financial position and will instead be deemed to refer (as the term trial balance already refers) to a mere step, or point of arrival-and departure, in preparing such a presentation. This possibility the committee leaves for future exploration.’

883 APB (1970, Footnote references omitted). ‘133. The financial position of an enterprise at a particular time comprises its assets, liabilities, and owners’ equity and the relationship among them, plus those contingencies, commitments, and other financial matters that pertain to the enterprise at that time and are required to be disclosed under generally accepted accounting principles. The financial position of an enterprise is presented in the balance sheet and in notes to the financial statements.’

884 Definitions found in SAC 4 include, ‘13 Statement of Accounting Concepts SAC 2 “Objective of General Purpose Financial Reporting” defines financial position as the economic condition of a reporting entity, having regard to its control over resources, financial structure, capacity for adaptation and solvency. The primary financial measures of an entity’s economic condition are reported in the statement of financial position, the elements of which are assets, liabilities and equity.’

885 Research continues at the social and economic levels (Kahneman & Smith, 2002; Cowen, 2006). Chambers’ argument would see interactions at those higher levels rather than at his tightly reasoned financial level.

886 McCrossan (2005, p11), ‘Note that, if behavioural economics were built into the conceptual framework, there would be a case for recognizing the value added in the financial reports. Just how that recognition should take place is a matter for further discussion.’ Barth (2005, p15), ‘One could envision what are presently considered as business risks to be recognized as liabilities. One also could envision expected future sales to be recognized as assets. This is a model for financial reporting very different from the one we have today.’
As analysed in 6.3, some pseudo-criticisms were rebutted by Chambers.\(^{887}\) Others met in 8.4.2 on measurement and in 8.5 on liabilities would see the reaffirmation of his main premises.\(^{888}\) He did cede a mistake with ‘realization’,\(^{889}\) due, in part, to ‘inadvertent adherence to an old verbal habit.’ He also ceded various points regarding details of application.\(^{890}\) However, his argument was maintained that accounting was of a contemporary, financial type which played a distinct function in economic and social actions. His use of the term ‘function’ was deliberate – ‘objectives’ resided in issuers and users of financial statements (Chambers, 1976a, p83; Chambers & Clarke, 1986).

In this thesis, it is argued that choice requires groupings of data for at least

- social
- economic, and
- financial (in place of conventional accounting, parts of which may appear in a distinct report).

It must be understood that this grouping differs in principle from the suggested multi-column financial statements (Gynther, 1971, 1972; Chambers, 1972, 1972a; Stamp, 1972) and its information overload emphasis, so relevant today with IFRS being applied to all entities in selected countries.\(^{891}\) Instead, importance of this grouping arises as factors from each grouping may weigh more heavily in a particular choice.\(^{892}\)

\(^{887}\) Chambers (1969a, p145), ‘But the rejection [by Leftwich] (p.245) of my conclusion on the utility of the kind of accounting I proposed goes beyond his stated brief, and thus exposes him to the charge that he did not take the whole of the argument into account.’

\(^{888}\) Chambers (1970a, p41-42), ‘But first may I say that my second thoughts on continuously contemporary accounting have only served to confirm my belief in the validity of the main ideas. Critics have attacked my exposition.... But none of the critics has attacked the main features of the argument. These are (a) that informed choice of future actions and informed appraisals of past actions depend on present knowledge of a present state; (b) that in respect of financial information there is no business function other than accounting which accumulates such knowledge; and (c) that such knowledge is only part of the premises of choice or judgement, the other parts being presently available external information and the (subjective) expectations of managers, investors and others who exercise choice and judgement. If these points remain unchallenged, and as they are the main grounds for the details of the whole system, I can only feel that my critics have left the main part of the structure unscarred.’ This is also argued elsewhere (1969a, p145; 1970a, p54).

\(^{889}\) Chambers (1970a, p43), ‘But I did make one serious mistake; ... The mistake was to make use of the idea of realization, in the conventional sense, in discussing the relation between inventory values and income. The conventional idea is that profit should not be anticipated. The balances which turn up in the balance sheet are what they are because this dictum is applied. My own system strictly has no use for this notion.’ Interestingly, McCrossan (2005, p10) has to deal with the same issue in his discussion of differences between ‘earnings’ and ‘value added’ in financial reporting by financial intermediaries.

\(^{890}\) Chambers, (1969a, p145), ‘I do not myself now agree with the details of some of the suggestions I made.’ Chambers (1970a, p50), ‘We are simply using the prices quoted in the market as the indicators of present cash equivalents. The phrase has been interpreted by some as indicating what is expected to be received in cash. And I think there are some points at which vagueness or poor choice of words on my part contributed to this interpretation.’

\(^{891}\) Chambers (1974b, p136), ‘Overload is, of course, one of the causes of breakdown. In the present case, if a receiver is overloaded with information, either he may neglect it in order to get on with things other than the task of digesting it, or he may attempt to digest the information and neglect some of the other things he is required as a functionary to do.’
Within those groupings, an accounting requires reporting of

- position, and
- performance.

Thus for a corporation, social position and performance statements, economic position and performance statements and financial position and performance statements would be prepared and disclosed. Only by chance would these be consistent with the balance sheet and income statement under conventional accounting. All statements would include items of a liability type. Illustrations of what might be included in the various reports are provided in 9.4 and Appendix IV.

**Independent but linked Conceptual Frameworks**

In Chapters 2-6, it was argued that the type of reporting sought in CG includes financial statements, but various arguments have developed regarding a tension found between conventional accounting and financial statements over time and currently. Further tensions follow from introducing economic and social issues within both conventional accounting and financial statements.

However, as argued earlier, economic or social position and performance statements are no longer radical suggestions (GRI, 2002). Work on CFs for these types of reports is ongoing and needs to be reconciled with that of the financial type, a task for those interested in interdisciplinary research studies, especially those dealing with issues of sustainability. Indeed, it is possible to argue that those like McCrossan (2005, p8, p13-14), Barth (2005, p1-2 & p3) and Barth et al (2006) who argue for the inclusion of future-looking valuations, risk measurement reporting and fundamental changes in financial reporting are working towards an economic CF.

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892 Here for example one may find a choice where positive financial and positive economic factors are outweighed by negative social factors. See Haigh (2006) regarding actions taken by the management of James Hardie Industries in dealing with asbestos-related health problems of particular stakeholders. ‘Obligations’ here led to ‘liabilities’ for ‘claims’ made by those stakeholders.

893 This idea was quite topical in the 1980s when attempts began to prepare a national balance sheet and a statement of the cost of running a country (MacMillan, 1986, p46). Attempts to apply similar ideas to sections of a nation have an even longer pedigree. A Defence balance sheet for Australia was suggested in 1960s, including the item ‘Alliances with great and powerful friends’ were to be included. There was some debate on whether the item was an asset or a liability (Robinson, 1968, p1).

894 Performance statements at the financial level are of two types – one of profitability, the other of cash flows.

895 Anonymous (2005, p15, emphasis added), ‘The project will assist professional and government regulators, as well as the public and private sector, to better understand how sustainability reporting can be integrated and applied in a formal planning, risk management and decision-making context. It will also ease the burden on business and government by developing a rigorous framework for classifying, measuring and reporting various forms of sustainability information.’ See also Wallage (2000); Atkisson & Hatcher (2001); Bebbington (2001); Walters, (2003a); Staunton (2003); Dillon (2005).
9.3.4 Proposition 4 and issues of definition and recognition

In Chapter 8, it was established that a series of terms were found regarding 'liabilities', suggesting a hierarchy. Those there included may be allocated to particular position statements. For example, conventional accounting may adopt

- claim
- debt.

Financial position may adopt

- liability.

Economic position may adopt

- obligation.

Social may adopt

- responsibility
- duty.

A key inter-relationship here is that the items are cumulative as the argument moves from conventional accounting to financial to economic to social. For example, from this it is inferred that responsibility and duty include all other terms.

Another alternative is to simply add to the term 'liability' conventional, financial, economic or social, producing a phrase for each. Again the inter-relationships are cumulative. Thus financial liabilities would be a subset of economic liabilities which in turn would be a subset of social liabilities.

Under CoCoA, an economic or social liability would become a financial one when a formal contract was agreed to by relevant parties.

9.3.5/9.3.6 Propositions 5 and 6 and the measurement dilemma

As highlighted in Chapter 7, tensions here became one of the main obstacles faced in the development of the USA and Australian CFs. With little resolution in sight at present, tensions persist. Consideration needs to be given to a number of issues.

The time factor

This requires in the decision/choice context a differentiation among past/retrospective, current/contemporary and future/anticipatory items (Walsh, 2004). Both Chambers and Sterling made this distinction most strongly. A puzzle is often set as to whether others (Campbell, 2003, p37) appreciate this point in Chambers' argument. For instance, Borio & Tsatsaronis (2005, p2-3) conclude

1. valuations (being not uniquely nor objectively defined) and the concept of unbiasedness need to be interpreted cautiously;

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896 For instance, Bewley (2005, p1) in her research refers to 'environmental' liabilities which may see overlapping among financial (contracts to regenerate destroyed areas), economic (promises to clean up toxic waste) and social (missions to improve air quality).

897 An illustration here would be the social (and perhaps economic) liability of asbestos companies which, after years of debate, became through social persuasion a legal-cum-financial one – recall Footnote 892. This is incorporated in pro forma reports suggested in Appendix IV.
2. as valuations are inherently forward looking and risks require to be measured and priced, risk measurement technology is important in calculating value;
3. a shift to fair values in accounting introduces forward-looking elements, thus putting a premium on verifiability;
4. the shift in 3. also puts a premium on transparency, and
5. considerable scope still exists to bring accounting valuations closer to economic valuations.

Chambers’ argument is consistent with the above except for 5 above and its attempts to introduce economic valuations into financial statements. This would be too broad for CoCoA – the financial level - where only selected economic valuations – retrospective and contemporary price ones – would be included. That is not to argue that economic values are unnecessary – they do play a part in choice, being part of Chambers’ ‘total scene’.

A paradox met by including anticipatory, economic-type data in the valuation of liabilities has been revealed by the arguments and actions of the so-called ‘new actuaries’ (The Economist, 2006d, p61). The large fall in equity markets in early 2000s had major consequences for both private and government pension schemes. Supposedly financially healthy, the amounts of both the liabilities and the assets needed to meet them were adversely affected. Actuarial and accounting reasoning and practices were questioned.

Consider the 1970s when an exchange occurred in the semi-professional literature. Chanticleer (1975, p20), writing of the then expanding area of superannuation plans and employee entitlements, showed concern with the different assumptions used by actuaries in quantifying various factors of models underlying related reports on superannuation funds and their future plans. Coss (1975, p2-3) took exception with Chanticleer’s implication that predictions (in a forecasting sense) were involved. Instead, he argued ‘the actuary has to make many assumptions about the future which should in no way be viewed as predictions.’ Chanticleer (1975a, p28) ceded the point, but wondered if managers of funds appreciated this, as he had originally thought in terms of ‘predictions’. At least, readers of such reports had to be aware of any assumptions made and perhaps the potentially wide range available therein.

Some years earlier, Forsyth (1967) had supported the need in the education of accountants for an emphasis on quantitative methods (including calculus, linear algebra and statistics – key components of model development). Chambers (1967c) suggested that while Forsyth’s plea for accountants to have greater mathematical literacy had merit, the argument missed a critical point. Especially under

898 The Economist (2006d, p59), ‘False precision and reckless approximation have defined the actuarial profession’s role in the crisis that has enveloped corporate pensions on both sides of the Atlantic. Although actuaries have not been the only cause – companies, trustees boards, governments and accounting rules have all played their part – they have been surprisingly hapless at their main task: forecasting funds’ future liabilities and assessing how many assets will be required to meet them.’

899 Chanticleer (1975a, p28), ‘For if actuaries are not prepared to “predict” the future then what they surely must do is to present the management of superannuation funds with a choice of actions based on various assumptions. They may recommend one of them but the managers must be very clear that the actuaries’ guess is not a prediction.’

304
conventional accounting, accountants' education lacked an understanding of the conditions under which even addition may be performed. To him, there seemed 'to be a belief abroad that by some mathematical wizardry inexact data can be made more exact.' Instead, he argued for reliable, contemporary data to underlie any future estimates (one requirement for choice). However, such estimates had no place as the basis for contemporary financial position (another requirement for choice).

Despite Chambers' warning, in the 1980s interaction among social (for example, changes in life styles) factors, economic (for example, deregulation of once fixed prices, interest and currency exchange rates as well as oil price rises) factors and accounting continued. Two interactions were emphasised, one on the reporting of forecasts and another on the use of models.

Beaver (1978, p52; 1981) supported the argument that regulation of disclosure was an economic issue, not a legal one. He saw this leading to 'a broader set of disclosures in annual reports' and 'the intrusion of current value and future-oriented disclosures in financial reporting.' Debate continued on the publication of profit forecasts in annual reports (Pound, 1981, p517). Arguments for and against were canvassed but no resolution suggested (Ferris & McDonald, 1982). The issue would be recycled some decades later (Glover et al, 2005). The reliance on models is returned to later in the chapter.

In Chapter 8, it was argued that Chambers (1966a) would base decisions or choice on the relationship between 'monetary values' and 'exit prices' where the former were basically anticipatory and the latter contemporary. Sterling (1979) made similar decision-rules a key part of his argument for exit-price accounting.

This does not suggest that Chambers excluded the reporting, and use, of anticipatory data. Indeed, such data are part of any informed choice. However, they had no place in his statement of contemporary financial position and related financial performance which he regarded as generally relevant data for decision-making (Chambers, 1976d).

At the social level, indicators are used to measure various non-financial items (Parmenter, 2005, p54). These indicators of course do not possess additive properties and tend to have high specificity. Also incorporated are the financial measurements and calculations found in the narrower sub-sets. At the economic level, financial measurements are found without Chambers' constraint of past or current prices.

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900 Chambers (1967c), 'The evidence of this lack of understanding is almost universal. All around the world figures in balance-sheets are added in defiance of the rule that only magnitudes of like dimension may properly be added. Amounts of cash presently on hand are added to the prices paid, different numbers of years ago, for land, buildings, plant and securities - as if the sum could have any sensible meaning at present.... It seems to be dangerous in the extreme to foster the manipulation, through the use of sophisticated mathematical devices, of numbers derived in such a loose way.' In the Collection, this is USA P202, Box 23, #11933.

901 The Economist (2005, p16) argued that the tensions between management and regulator were leading to professional accounting bodies supporting reforms in the way corporations accounted. The reforms included the reporting of present value of liabilities (and assets) rather than the reporting of historical cost values. The new system is called 'fair-value' accounting. However, this system made it easier to carry out some irregularities (this was in part a fault detected in the Enron case). It is suggested, 'The reforms therefore need reforming.'

305
the financial level, CoCoA would include past or current prices. Others suggest a full or partial marking-to-market of liabilities (Lonergan, 2000; Knight, 2005, p2). Again, while part of the ‘total scene’, such indicators would not be part of Chambers’ contemporary financial statements.

**Market turbulence or underlying economics of a firm**

Some argue for the exclusion of selected changes in the fair value of liabilities (and assets) in the profit determination process as the resulting volatility in markets was ‘false’, not reflecting the underlying economic trends in the firm (The Economist, 2005). Chambers’ CoCoA also faced similar criticism in that he would include, in financial performance, increases or decreases in prices, even if not ‘realized’. He argued that the reporting of contemporary financial position and related performance was paramount. Underlying economic trends were of a distinct order.

McCrossan (2005, p6-7) writes of attempts to use ‘smoothed values’ to deal with excessive price volatility. However, he rejects and does not advocate the practice, preferring instead ‘to use statistically credible observations of behaviour’ to resolve issues of recognition and measurement. Certainly, the old argument for smoothing profits/managing earnings remains topical – leading to manipulation of reporting, arguably to the detriment of investors, consumers and other employees (Gebhardt, 2005, p20).

**Availability of markets**

As shown in 8.5, Chambers argued against liabilities for which there was a ready market (like bonds), being included in contemporary financial position at that market price. He rejected arguments of trading in liabilities which he instead saw as constraints on the entity’s ability to so trade.

Those who disagreed also faced the problem of some liabilities not being traded on high volume, liquid markets. In other cases, liabilities like mortgages were sometimes bundled into ‘collateralized mortgage obligations’ which in turn are traded in selected markets (McCrossan, 2005, p5). Lacking a verifiable market price, models (often complicated) based largely on subjective estimates are used to determine ‘fair value’ (Chapter 8). Tensions necessarily followed (The Economist, 2005).

While not including items under CoCoA if they incorporated anticipatory data, Chambers would agree liabilities like

- employee entitlements for annual leave, sick leave or long-service leave,
- superannuation entitlements,
- claims for damages (for example, asbestos health cases),
- warranties, and perhaps
- restoration of environmental conditions

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306
require disclosure. Contemporary material might be used to calculate a 'contractual amount', but these would, to be incorporated in Chambers' CoCoA, incorporate only past and contemporary data.

To some (Leftwich, 1969; Gynther 1972), Chambers' argument sought to do away with professional judgment (of practicing accountants and other experts). As often found in the study, debate was at cross purposes. The debate was not about disclosure of estimates by say an actuary and the underlying assumptions. Chambers was well aware that these anticipatory amounts and changes in these estimated values over time needed to be reported and classified into those resulting from

- a change in market conditions,
- a change in the underlying business, and
- those based on bad previous guesses or forecasts.

Identifying events here requires the application of judgement (Barth, 2005, p10). However, while they had no place in Chambers' contemporary financial statements, he did regard them as necessary in making 'choices' or decisions. Similar tensions arose from suggested reporting in financial statements of both historical cost and updated fair value of selected items and a reconciliation of the two figures.

Chambers argued that at the application level, judgment was certainly required. However, it must be based on underlying reasoning or an ideal being sought. An illustration was the false claim that under CoCoA, resale price was unequivocal. Chambers' argument remained that professional judgment was required, but it was not concerning the choice among the often inconsistent rules of conventional accounting. Instead, it was a choice among markets in which trade took place and the related prices. Chambers (1970a, p53) argued,

The necessity of judgement None of these sources will necessarily give unequivocal resale prices. But their existence certainly gives assurance that there is extensive evidence on which informed judgement could be exercised with the object of approximating resale prices. There may be some who have supposed that my proposals were so tightly phrased that I excluded the exercise of judgement. The tightness of my specification, however, relates to

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903 Chambers (1969a, p144), 'I am not a little intrigued by what Leftwich calls "the docile role of the accountant in Chambers' model" (p.244). The disciplines of science are by no means easy. The characteristic objectivity and neutrality of scientific knowledge are hardly won. They are won against the common wish to believe in what we believed in yesterday, against habits of thought which are comforting and comfortable. There is nothing docile about this. The task of finding out the contemporary facts, as I described it, is a task demanding a much less docile attitude than the mere acceptance and transmission of opinions obtained from management, as Leftwich suggests (p.243). Indeed, Leftwich unwittingly shows how docile some of today's accountants are.... If the experts disagree, why should anyone, Leftwich and I included, accept their judgements as guidance or authority? To do so is docile in the extreme, supine even. It is especially piquant to find Leftwich chiding me for ignoring the experts when already in his introductory pages he indicated at length the messy state in which accounting theory and practice now stand.'

904 Chambers (1970a, p53), 'But when we set up an ideal type of information, and ask that accountants use their best skill and judgement in approximating it, then there is a real opportunity for using judgement. Skill and judgement are demonstrated only when one has to work within limits, or to an ideal.'
the principles to be used, not to the identity of the magnitudes derived. I wrote explicitly of approximation, and "the best possible approximation to cash equivalents". These very words imply the use of judgement.

The exercise of judgement has long been the trump card of those who favour freedom of choice among the vast array of "invented" accounting rules.

He was of course more concerned with questions of principle, though any application involving the related principle allowed for approximations, as met in 8.4 and 8.5.

Availability of models
As met in 8.4, a phrase gained some notoriety as a result of the Enron case - 'mark-to-model', (obviously a corollary to the 'mark-to-market' technique used to control actions of traders in the futures markets). Sophisticated models have been developed which are based on what McCrossan (2005, p15) terms 'credible observations'. Work continues here in various areas (Gebhardt et al, 2004; McCrossan, 2005, p6&7; Landsman, 2005, p8; Peasnell, 2005, p21-23; Borio & Tsatsaronis, 2005, p2-3) as well as the use of the Black model to option pricing (Franke et al, 2006). Inputs here include anticipatory data which certainly have a function in economic and social reporting - indeed they are indispensable to choice, especially of a policy type. However, in this study, it is argued that once anticipatory data are included, the output becomes part of an economic framework. That is not to deny that the output is a major part of decision-making (or Chambers’ choice), as Chambers (2000a, p327) argues,

There is scarcely any part of life that is free of the influence of our own imaginations or the products of the imaginations of others. In matters of consequence to ourselves that entail dealing or interaction with others, we must therefore be constantly on guard against confusing facts with figments or fictions.

While market-to-model techniques may be used in the valuation of selected liabilities, only past or contemporary data must be used to meet Chambers' criteria.

9.4 Consequences for the annual report
For some decades, potential changes in the annual report have been noted (Tricks, 1981; Olsson, 1981; Alexander, 1999). Ravlic (2005, p42) suggests bodies like the ASX currently prefer management to 'tell a story' rather than simply provide a series

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905 In some institutions, traders are required to 'close off' their trading positions at the end of their session. In the absence of collusion or deliberate concealment of bad trades, losses are minimised and disclosed. See McClean & Eklund (2003, p40), 'Historical-cost accounting allowed [firms] to keep loans that had collapsed in value on their books at wildly inflated prices, which in turn allowed them to hide the true state of their finances. By contrast, Wall Street firms, which have to use mark-to-market accounting to value their portfolios, take hits when, say, the stock market collapses, because they have to mark the value of their assets to the current market price. Mark-to-market accounting, in fact, is an important component in ensuring the "transparency" of portfolio values. Because portfolio managers are forced to mark their holdings to market every day, their investors know precisely how much they've made – or lost.'

906 Chambers (2000, p327) continues, 'To help maintain that vigil [against 'figments'] is among the functions of scholars and institutions of higher learning.'
of complex numbers. However, financial statements, with their reliance on AAS, remain a key part of the Annual Report.

Chambers (1980b, p397), as in so many areas, provided a rationale underlying AAS. The argument is found in various areas. Standards provide systems to ‘standardize’ applications, leading to advances in knowledge and technology (Crosby, 1997). With the move from crude instruments and measures to more superior ones, advances in financial accountability, business efficiency and deployment of resources might be expected to follow.

In this thesis, it is argued that Chambers’ CoCoA would play a key role by providing the financial statements. These would be quite distinct from economic or social reports. Illustrations of pro forma reports and related items are included in Appendix IV.

The financial statements – under CoCoA – would include the contemporary financial position at a point in time of the entity with assets at the current, exit price and liabilities at contractual amount. The resulting performance during the previous period would be calculated after allowing for movements in prices generally (the capital maintenance adjustment) and excluding any anticipatory calculations. Arguments must be debated at the same level of abstraction. Too often as found over time (and shown in earlier chapters), arguments of measurement are actually arguments about definition or disagreements of attributes to be measured are actually arguments of the ‘total scene’ (including how various frameworks are interrelated).

907 Chambers (1980b, p397), ‘To be concerned with accounting standards is to be concerned with nothing less than the rationalization and standardization of a metrology. In other fields that step has been the precursor of significant advances in knowledge and technology. Men have done much with crude tools, crude instruments and crude measures. But they have never known how much progress lay before them until superior scales, instruments and controls became available to them. The tools now available in aid of financial administration are still crude tools, poorly articulated, never deliberately designed to deal effectively with any other matter than cash flows. But, as it seems to me, there is a vastly greater opportunity for the identification of varieties of financial and administrative malaise, and for their treatment, than has yet been imagined or explored. And it seems possible that financial accountability, business efficiency and the deployment of resources generally could be kept under more orderly and more exacting scrutiny than hitherto. It all depends on how soon a comprehensive, versatile, realistic, up-to-date and continuously up-to-date accounting comes to be adopted.’ See also Stamp (1980a, p20-29).

908McCrossan (2005, p12) introduces a recent development, ‘For nearly a decade, Insurers have been increasingly showing ... values [reflecting the incremental expected return on equity from behavioural economics model], and their movements, either in the audited notes to the financial statements or in unaudited supplementary information to the financial statements under the caption of “embedded values”. Analysts became comfortable in analysing insurers based on trends in earnings and embedded values combined.’ However, he does lament inconsistencies in reporting from the lack of standards. Peasnell (2005, p3) also draws attention to the movement by FASB and IASB ‘to require detailed supplementary disclosures.’ See also AASB1032 (1996).

909 Chambers (1969b, p367, emphasis added) sought to isolate ‘the features which distinguish a financial information system from other symbolic systems and from the empirical systems which underlie symbolic systems.... A symbolic system is essentially a designed analogue machine. But if it is a system relating to socio-economic affairs, its design may be as difficult as the comprehension of the substrate socio-economic system.’
From these statements, ratio analysis and development of indicators (like current or quick ratios) would be available for financial risk assessment.

The financial statements may be supported by elements from the conventional accounting reports. These elements would be consistent with the narrow stewardship function of reporting, highlighting information about capital subscribed by shareholders, types of shares, investments of funds in large projects and cash flows.

Economic reports would introduce non-financial measurements and calculations (including barter arrangements, Bellos, 2001), anticipatory data, economic goals and targets for future periods, thus expanding on the contents of the financial statements. While an economic position statement may be developed at the national, sector or industry level, in the thesis the emphasis is at the entity level.

For example, a Value Added Statement has been proposed (ASSC, 1975; McMonnies, 1976, p99). While this rearranges selected information found in the financial statements (AASB1044, 2001), it may introduce further economic data like that concerning the competitive and regulatory environment. As well, industry macro-economic type data like, if in mining, the total, world-wide reserves (Callus, 2004) and inventories held, consumption rate (both contemporary and expected) and metal prices may be reported. If appropriate, the contribution to GNP (in dollars or as a percentage) may be included.

A key function of these reports is to provide anticipatory data. These may be in monetary, other quantitative or qualitative terms. If monetary, the value-in-use or net realizable value of assets and the potential settlement amounts of obligations may be reported. As regards liabilities for bonds for which a market exists, this obligation may be reported at that amount and reconciled with the contractual amount reported as the liability in the financial statements. Obligations for items like employee long service leave may be at an actuarial amount, again possibly reconciled with the contractual amount reported in the financial statements. For obligations for claims made by employees against the entity, factors to be considered include chance of success in defence, potential settlement amounts, number of claims (actual or expected) or discount rate to be used suggest an amount calculated from either an actuarial or an entity-specific model.

Models may involve non-monetary numbers. Such figures may of course be reported in their own right. As regards contingent obligations to customers for say warranty provisions, reports may include claims (perhaps as the percentage of total customers),

- actually made,
- successfully defended to date,
- settled out of court,
- withdrawn by the claimant, or
- otherwise dealt with.

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910 A plausible case may exist for data here to be included in the Social Reports.
These data may be of past and contemporary experiences or that expected. The reporting of the data may follow the guidelines found in Managing for Outcomes (Queensland Treasury, 1997). Work in that area includes monetary measures and non-monetary indicators.

Social data to be reported continue to be discussed (Shiraz, 1998; Frost, 2003, p690-716; Graham & Neu, 2003, p450). Reports here would include data on policy development, policy application, qualitative description of various items which may be reported and much of the data presently found within extant non-financial indicators (Sullivan, 2002).

Environmental issues are certainly incorporated, although often in stand-alone reports. Items included range over general ones of principle (Ball, 1996), institutional ones regarding MISs required (Burritt, 1998) and the need for standards (Burritt, 1999), including one on 'liabilities' (Wood, 1998). As well, particular items of financial, economic and social types are illustrated (Surmer & Vondra, 1992), often in the context of triple-bottom-line reporting (Charles, 2005).

Linked with these reports is the CG Statement (met in 7.3). A moot point is whether this should be retained or perhaps integrated within the above set of interrelated reports, as data included may already overlap with present statements. One area concerns risk and its analysis (ASX, 2003, p11, Principle 7).

Maloney (2005, p47) points out that the concept of risk management has existed for decades. In more recent decades, business executives have applied the concept now researched and taught in academia. Interactions with accounting were found (Zuber & Berry, 1992), but as found in earlier Chapters, again seemed to be at a level different from Chambers' contemporary financial position and performance. Maloney (2005, p48) implicitly agrees, debating whether, after various financial collapses, the 'right questions' were being formulated including those of the quality of data found in financial statements.

As a direct result of corporate collapses like Enron in USA, the Committee of Sponsoring Organisations (COSO) has developed an Enterprise Risk Management Framework (Campbell, 2005, p58). The more traditional internal controls within an

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911 For instance, reasons for sudden high profits, as found in oil-related companies, may be identified and explained (Bailey, 2004).


913 Maloney (2005, p48-49), 'While these post-collapse remedies (or is that responses?) may stop more such collapses in the short term, we should also be asking why they occurred in the first place.... Perhaps our so-called experts are lacking in imagination, or don't ask the right questions, or are not allowed to ask the right questions; or perhaps they don't know enough or are not realistic enough to know the correct questions to ask.'

914 Maloney (2005, p49, emphasis added), 'When the bottom line appears sound, shareholders are happy, executives continue to receive their packages and customer service continues to decrease. Then "all of a sudden" the curtain is torn and the true picture is revealed, dividends stop, the share price tumbles, the company downsizes if it is lucky, or its assets are sold off to pay creditors. Staff lose their jobs.'
enterprise are seen as one component only of risk analysis, which is broadened to include external issues like compliance and reporting to other stakeholders. Indeed, it is suggested a 'large new risk industry' now exists (The Economist, 2006g, p11).

This suggestion is consistent with IFRS 7 (IASB, 2005) which requires disclosure of estimates of credit risk, liquidity risk and market risk.\footnote{Barth (2005, p22) points out that disclosure of most estimates is of a mean; disclosure of variance she suggests 'can be important to users in making their economic decisions.'} In the case of financial intermediaries, McCrossan (2005, p8) suggests exposure is had to

- financial/economic risk, and
- customer behavioural risk.

He sees both as influencing the estimates of the valuation\footnote{Peasnell (2005, p23-24) comments, 'Financial institutions apply and regulators oversee complex risk management strategies using value at risk techniques. In this new world, the application of fair value accounting to financial instruments presents a huge opportunity to advance the quality of financial reporting by financial institutions. The measurement problems are formidable.'} of assets and liabilities which are eventually included in the firm's reports. Similarly, Borio and Tsatsaronis (2005, p1) seek 'an agreed, richer information set about the financial characteristics of a firm' which covers

- point-estimates found in present financial statements of current financial condition,
- estimates of risk profiles, and
- measures of uncertainty.

However, they do not expect full reconciliation between financial statements and risk management.\footnote{Borio and Tsatsaronis (2005, p20), 'It is clearly unrealistic to expect that the needs of accounting and risk management could be fully reconciled. Tensions are bound to remain as a result to differences in the objectives and "degrees of freedom" in the two disciplines. Questions of what can and cannot be recognised as assets and liabilities, based on criteria such as the verifiability of the corresponding amounts, are an obvious example. Even so, there seems to be considerable scope for a narrowing of the gap between the two perspectives. It is desirable to strengthen efforts to this end.'} Arguments here seem consistent with Chambers' 'total scene'. However, caution is needed in determining the monetary amount to be included in corporate financial statements.

Coughlin (2005, p9) certainly agrees as 'accounting in the 21st century is about much more than numbers'. The skills used in what he terms traditional functions (audit, accounting standards, financial reporting and CG) are now to be used in areas of non-financial data for use in strategic business thinking, innovation and leadership within a context of a broader concept of corporate accountability.\footnote{This context is referred to under various titles – corporate social responsibility, corporate sustainability, triple bottom line reporting – a bane on progression met in the thesis which leads to confusion.} This too is consistent with Chambers' idea of accounting being a generic term capable of covering interdisciplinary matters. However, CoCoA remains a constrained and well-defined process to produce contemporary \textit{financial} position and performance, though the process remains systematically linked to broader reporting of \textit{economic} and \textit{social} types.
9.5 Chambers, his vision and the future of CoCoA

Historical documents and their analysis cannot alone tell the whole story of Chambers’ CoCoA. Certainly a researcher may be charged with being untrustworthy on particular emotional aspects, even though in cases like this study, emphases are placed, as did Chambers, on external verity and internal logic.919 While an undermining of established institutions of authority (such as those in which conventional accounting held sway) may be seen as a triumph of the inquisitive mind or a relentless quest for truth, it is not without costs at various levels of society.

Some remained completely critical of CoCoA, finding few if any redeeming qualities. Anderson & Leftwich, (1974) attempted to undermine the system, but Chambers (1974) in turn questioned the logic of their argument. Stamp (1983, p127) concluded of a Chambers’ survey in particular and of CoCoA in general,

One could sum up ... by describing it as a curate’s egg. It is good in parts, but a good case is spoilt by exaggerations and omissions ....

Indeed, when Chambers is confronted with the case for replacement cost he is apt to allow his querulousness to get the better of him.... If the case for CoCoA has to stand on that style of argument ... it will surely fall.

This conclusion would be expected in argument basically founded on denunciation (but diluted with devious compliments). Despite being originally in support of Chambers’ thinking (Collection, SUA P202, Box 58, #10385; Box 30, #9247), Stamp eventually became most sympathetic to the CCA/replacement cost method (Box 23, #8063). Despite such tribulations, Chambers persisted with his argument.

Being well versed in his discipline of accounting and related professional practice, Chambers spent much effort studying developments in other disciplines and professions.920 Nevertheless, interdisciplinary study does provide a means to resolve tensions in both underlying reasoning and applications. He held strong views on relations between professional organisations and universities, especially as regards research, seeing tensions arising from both sides.921 While his research left a clear

919 Knight (1955, p268), ‘What makes economic reviewing (and all criticism, and discussion) difficult is that writers and teachers of standing do not agree on the ABC’s of their subject, the definition of their “science” and its elementary concepts, and the statement of its first principles.... But one cannot appraise ideas without judging men – making “odorous comparisons.” For, in judging another one is implicitly judging oneself, and must leave it to the “gentle reader” to judge where the judgment falls. A reviewer must point out “errors” and try to find their roots, not for the sake of controversy but for the sake of “the cause,” of truth, in this case of education in economics – beginning with mutual education of the educators.’

920 Chambers (1983, p466-467), ‘The history of every trade and profession has been marked by a long period of practice based on tradition, on trust by the present generation in the wisdom of the rules of thumb, conventions and doctrines of its forebears. In many fields, however, progressively superior knowledge and skill, new levels of excellence, have emerged, when the traditional wisdom has come seriously under question.’

921 Chambers (1983, p467-468), ‘In many places the professional organisations and their auxiliaries pay little attention to the capacities of the universities for research on practical matters. They have their own researchers “in house”, removed from the atmosphere of independent inquiry of the universities and strongly conditioned by the conventional wisdom of their time. In many places, on the other hand, university researchers pay little attention to the application of theoretical analysis to the technical
message in principle, debate becomes a little muddier when application issues are considered. How would he set about resolving application problems met in accounting for

- ‘liability’ for executive options which for part of compensation plans,
- pension obligations, or
- claims by those affected by asbestos-related health concerns,

being debated at the social and economic level? He would resolve the issues at the financial level by a constraint of using past and contemporary data only.

The two following quotations summarize the vision (and frustration probably met) in the development of CoCoA. In the first, Chambers (1969b, p368) reveals at a general level what he was about and his intolerance of excuses for not dealing with ‘the total scene’:

> [W]e may easily invent systems for doing something. It is only a little less easy to invent a system for doing many things. It is rather more difficult to construct a symbolic system which will do many required things under constraints imposed by diverse elements of the matrix of the system. It is much easier to neglect the knottier problems or to slip too many of them into ceteris paribus. But the result will serve poorly the conduct of practical affairs. Only a system which corresponds as closely as possible with the elements of the empirical matrix and takes account of their interdependencies will serve.

Regarding the second, Chambers (1970b, p28), criticising the then financial statements (criticisms which perhaps still remain current), showed his frustration with exclusion of acquired knowledge – especially of a quantitative type - from accounting:

> Financial statements at present are very similar to the pronouncements of the Greek oracles. The deliverances of the oracles, you may remember, were couched in terms which could be interpreted in more ways than one. Whatever course was chosen by those who consulted the oracle, the outcome could be shown after the event to tally with what the oracle said. The modern counterparts of the oracles, of course, are the astrologers, whose horoscopes are similarly vague. In an age in which knowledge and deliberate calculations have so extensively supplanted divination, it is odd to find such vague, contradictory and inconsistent pronouncements in published financial statements, as one might find in the pronouncements of the oracles and astrologers. One can scarcely avoid the conclusion that we have advanced little in this respect in over 2000 years and to judge by the mounting criticism, the business community seems to think that is not good enough.

The fabric of accounting – both its so-called theoretical justifications and its practices – are shot through with fundamental errors.
It should perhaps be remembered that Chambers’ resort is to scientific inquiry and knowledge (with its emphases on observation, mathematics and measurement). History tells that over time, these were regarded with suspicion by many, being linked to ‘magical’ pursuits and even to practices in the occult (Woolley, 2001, p20-21, p54-55).

Some comfort may be gained from words (The Economist, 1843) written in times discussed in Chapter 2,

It is one of the most melancholy reflections of the present day, that while wealth and capital have been rapidly increasing, while science and art have been working the most surprising miracles in aid of the human family, and while morality, intelligence, and civilization have been rapidly extending on all hands — that at this time, the great material interests of the higher and middle classes, and the physical condition of the labouring and industrial classes, are more and more marked by characters of uncertainty and insecurity.

In current times of debates on Globalisation and on the growing spread between rich and poor, Chambers’ words of wisdom, rather than being seen as one of the temporary blips in the arguably un-winnable attempts

- to make management accountable within a CG framework, and
- to provide information in a systematic way for decision-making or choice,

will continue to be cited and used in research.922 It in some ways seems strange that CoCoA — a challenge to the traditions of the May Legacy — is now challenged as too traditional in its lack of use of models and formulae used in financial markets. Of course, debate becomes unnecessarily complex as data are mixed from distinct time periods and by the function of accounting moving among distinct disciplinary levels. The boundaries of commonsense would seem to treat sceptically claims that ‘investment could be turned into a quantifiable science in which profits were virtually guaranteed’ (Thomas, 1999, p24). An appreciation of Chambers’ total scene (including CoCoA) would seem an alternative, potentially more fruitful, claim.

9.6 Summary and conclusions
With certainty, debate will continue on the definition/recognition of liabilities923 and their measurement.

922 Chambers’ influence perhaps simply follows that of revolutions over time, as suggested in The Economist, (2006f, p15), ‘As a rule, some people, such as Jacobins, tend to be more enthusiastic about revolutions than others, such as monarchs. Another fairly reliable rule is that revolutions abrupt enough to be associated with a single year (1642, 1789, 1848, 1917) tend to cause trouble but rarely bring lasting change. By contrast, revolutions gradual enough to be associated with a name (Renaissance, Reformation, Industrial Revolution) often do have enduring effects. A third rule, of hypothesis, might be that revolutions seem to be entirely for the better or the worse, but somehow manage to combine both.’ Chambers’ ‘revolution’ was associated with the name CoCoA. Arguably, effects being enduring, although any benefit/cost analysis remains ongoing.

923 Clarke et al (2003, p307), ‘The fantasy of injecting financial statements with artefacts of the system — those data neither indicative of a financial state nor representative of an actual asset, liability, revenue or expense item — is [to be] avoided.’
In this thesis, debates in general and under CoCoA in particular have been examined. The topic was broad, but the analysis attempted to put a context around what Chambers was ‘actually saying’. Gaffikin (2003, p247) recalls that the term 'historicism' is a most debated one. On one hand, it may be used to signify that an historical event or process (like CoCoA) only takes on understanding within the then context. On another, it may be used in an argument that the future of society may be predicted if only the laws of historicism could be identified and understood. The latter, as Gaffikin notes, was severely criticised by Popper (1957), especially regarding Marx’s use of the laws of historicism to predict the collapse of capitalism.

The former has been the approach adopted here to analyse the literature generally on accounting for liabilities and, more specifically, Chambers’ development of CoCoA and its reporting of liabilities. Indeed, the argument is written in the vein of Gaffikin’s ‘new historicism’. Gaffikin (2003, p248) suggests three ‘interlocking and intricately entwined aspects of knowledge’ - historical explanation, language and culture - are needed to appreciate significant events or processes of preceding centuries.

It is argued that CoCoA is such an event or process. In this thesis, ‘culture’ and ‘language’ are kept constant by the emphases on events from the Anglo-American view. ‘Explanation’ is determined from the analyses of various writings, debates and the resolution of issues concerning liabilities, within the context of stated propositions/hypotheses as proposed in Chapter 1.

The first step was to identify the research problem. It had to do with the reporting of liabilities. This required a stated context which was established in Chapters 2-6.

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924 May (1942, p35), ‘Quite apart from the question of proprietorship in relation to liabilities, the accounting concept of a liability for balance-sheet purposes is a complex one which is difficult to define accurately except in relation to accounting rules and principles.’

925 Greeley, (2001, p173), ‘It astonishes me that many of us read into a man’s work what we want to find and do not hear what he is actually saying.’

926 Gaffikin (2003, p247), ‘The well known and oft-quoted philosopher, Karl Popper, has suggested that we do not learn from history but there is little doubt that development of ideas is often shaped by those who preceded them. Such sentiments are nowadays received with skepticism as they imply that we move inextricably to the uncovering of some foundational base for all knowledge.... Many ... have debunked the notion of a linear progression in our understanding of our and other worlds. Nevertheless, there have been moments that have changed peoples' thinking whether they be called revolutions or crises.’

927 Dean (2003, piii) summarises a key thrust of CoCoA as ‘the need for a core principle of serviceability to govern the provision of “truthful” accounting data rather than the current “cookbook of rules” (the black-letter approach to regulating corporate financial reporting).’ Gaffikin (2003a, p295-6), ‘Chambers’s work represents the first comprehensive attempt at providing a new general theory of accounting which would lead to a new practice of accounting. It argues for a move away from accounting on the basis of historical costs to employing current replacement prices - market selling prices - later to be referred to as exit prices. Some parts of the argument proved to be defective so Chambers supplemented the book refining and amending some minor aspects, in later articles. Some earlier writers had written works clarifying, codifying and justifying some or all existing accounting practices but Chambers was presenting an entirely new theory of accounting which came to be known as continuously contemporary accounting (CoCoA).’
In Chapter 7, CF projects were used to stress the interest for decision-making and accountability issues of profitability and solvency in particular. In Chapter 8, issues of terminology and of measurement were analysed to resolve debates.

The development of CoCoA remains a key concern in any resolution of debates which unfortunately seem to follow the recycling process which Sterling (recall 1.1) identified several decades ago. For that cycle to be broken, it has been demonstrated here that the prescribed approach must:

- produce a contemporary statement of financial position,
- allow for tensions from a mixing of ideas and concepts of an interdisciplinary type,
- produce an interrelated hierarchy in the definition of terms,
- accept that values are distinct from prices, and
- allow for dilemmas, met in measurement, related to the time factor, markets and models.

Above all else, consideration must be given to

- 'The total scene' – one of Chambers' major themes.

928 Berle (1954, p180), 'Herein lies, perhaps, the greatest current weakness of the corporate system. In practice, institutional corporations are guided by tiny self-perpetuating oligarchies. These in turn are drawn from and judged by the group opinion of a small fragment of America - its business and financial community. Change of management by contesting for stockholders' votes is extremely rare, and increasingly difficult and expensive to the point of impossibility. The legal presumption in favor of management, and the natural unwillingness of courts to control or reverse management action save in cases of the more elementary types of dishonesty or fraud, leaves management with substantially absolute power. Thus the only real control which guides or limits their economic and social action is the real, though undefined and tacit, philosophy of the men who compose them.'
Appendices
APPENDIX 1
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Version 1

1. Definition of Financial Reporting: General Purpose Financial Reports

2. Objectives
   - Economic decision making
   - Accountability

3.A Elements
   - Definition of Assets
   - Liabilities
   - Equity
   - Revenue
   - Expenses

3.B Qualitative Characteristics
   - Applicability of Relevance
   - Reliability
   - Comparability
   - Understandability

4.A Basis of Recognition
   The criteria for recognition of the elements eg. - probability of occurrence - evidenced by transactions/events

4.B Techniques of Measurement
   Identification of techniques for the measurement of the elements eg. - Employee Entitlements: Actuarial Method?

4.C Basis of Measurement
   - Historical Cost
   - Current Purchasing Power
   - Current Cost
   - Current Cash Equivalents

5.A Financial Position
   - Relevance to Objectives
   - Items for Disclosure
   - Format of Disclosure

5.B Performance
   - Relevance to Objectives
   - Characteristics to be Disclosed
   - Format of Disclosure

5.C Financing and Investing
   - Relevance to Objectives
   - Items for Disclosure
   - Format of Disclosure

5.D Liquidity and Solvency
   - Relevance to Objectives
   - Required Disclosures

5.E Compliance
   - Relevance to Objectives
   - Nature of Disclosure
   - Details of Disclosure
   - Format of Disclosure

6.A Applicability
6.B Scope
6.C Audit Status
6.D Timing
APPENDIX II

FIGURE I
Building Blocks of a Conceptual Framework
for General Purpose Financial Reporting

Levels

1. Border of discipline/authority
2. Subject
3. Objective
4-5. Fundamentals
6-8. Operational
9-12. Display
13-17. Standard-setting policy
18-19. Enforcement

1. Definition of financial reporting
2. Definition of the reporting entity (SAC 1)
3. Objective (SAC 2)
4. Qualitative characteristics (SAC 3)
5. Elements (SAC 4)
6. Basis of recognition (SAC 4)
7. Basis of measurement
8. Techniques of measurement
9. Financial position
   a. Wealth
   b. Financial structure
   c. Capacity to adapt
   d. Solvency/liquidity
10. Performance
    a. Change in wealth/consumption of resources
    b. Variability
11. Changes in financial position
    a. Financing activities
    b. Investing activities
12. Compliance
   a. Meeting of requirements

13. Applicability (entities addressed)
14. Elevation - principle versus detail
15. Research methodology/transitional process
16. Requirement for audit
17. Policies or transition

18. Monitoring compliance
19. Responses to non-compliance

Standards
Regulation

320
Appendix III

A Conceptual Framework

1. Utility of the product. All parties of interest are concerned with solvency, debt-dependence, asset (investment) composition, and rate of return. Satisfactory indicators of all must be obtainable from accounts.

2. Arithmetical propriety. The indicators mentioned are derived from totals or sub-totals. All the components of totals and subtotals must be of the same kind if the totals and the indicators based on them are to be useful.

3. Historicity. By law and by general intention, periodical reports relate to past events and dated (past) positions. No element of the accounts may therefore relate to or depend on a conjecture about the future.

4. Comparability. All indicators of the financial features of business firms are only interpretable relatively to comparable indicators at other dates or of other firms. No accounting rule is acceptable that interferes with the validity of comparisons.

5. Periodicity. Since accounts’ relate to specified periods and dates, no item may be included other than items which represent transactions or events or their consequences occurring within the period of account.

6. Completeness. No accounting rule or practice is acceptable that provides for or allows the omission from the accounts of any period of the consequences in the period of any transaction or event occurring in the period.

7. Uniformity. Since accounts may be used by creditors, bankers, financiers and investors and their advisers, in ranking or discriminating between firms; and since indicator of solvency, debt-dependence, asset-composition and rate of return are only comparable if derived by the same rules and processes; accounting rules must, in principle, apply equally to all firms.

8. Financial position. The financial position of a firm is its capacity, by virtue of its beneficial possession of assets and its debts, to carry on its business, to meet its debts, and to vary its assets and debt, as short-run circumstances may require. A representation of financial position must provide indicators of that capacity and of facets of it such as solvency; debt-dependence and asset-composition.

9. Contemporaneity. The amount of any asset or liability appearing in a statement of financial position must be the best approximation (a) to the amount available or accessible to pay (or as cover for) debts, in the case of assets, and (b) to the amount of the debt, in the case of debts, at the date of the statement.
10. **Net wealth or Equity.** The net wealth of a firm, or its equity in its assets, is the difference between the amount of its assets (as determined under 9(a)) and the amount of its debts, at a stated date.

11. **Income.** The income of a firm in a period is the difference between the amounts of its net wealth at the beginning and the end of the period. It includes the realized difference between book values or purchase prices and selling prices of goods sold, and the accrued difference (positive or negative) between book values or purchase prices and selling prices of all goods in possession at the end of the period. In the event of inflation (or deflation), the sum of these realized and accrued differences must be reduced (or augmented) by allowance for the effect of inflation on the opening amount of net wealth.

12. **Contingencies.** The amounts of all costs and benefits that are contingent on future events at the end of a period are irrelevant to the accounts of the period then ended, and are conjectural. They should be relegated to explanatory notes to the accounts.

13. **Verifiability.** The discovery of asset and liability values as in 9 above, entails that they are independently verifiable. The amounts of contingent items referred to in 12, being conjectural, are not independently verifiable; but they might be subject to some note in the audit opinion on the reasonableness of the conjectures or of the grounds for the conjectures.

R J Chambers
March 1982.
Appendix IV
Implications for the annual report

The public company is probably, to society generally, the representative business institution; the institution which has the most direct bearing on the attitudes of the members of a community towards business. And the annual report may be regarded as the representative communication of business. It is really directed to the community at large, to whomsoever it may be formally addressed. All groups have access to it, the attitudes of all groups may be influenced by it.

It is fashionable these days to view the annual corporate report as some super communication vehicle carrying relevant messages to all users whatever their interest and association with the corporation. The loading up of the report with all sorts of financial, statistical, social and economic data and comment is seen as a means of rendering accountability in the most efficient (perhaps not effective) way.
Juchau, 1976, p487 (emphasis added).

By any measure, Goldman Sachs is a formidable company. ... Like most of its rivals, Goldman is a difficult institution to understand. Until 1999 it was a private partnership. With public ownership came greater reporting responsibilities, but precisely what Goldman is up to remains obscure.
The Economist, 2006g, p11.

(i) Extracts similar to elements of Conventional Accounting\textsuperscript{929}

\begin{table}
\centering
\begin{tabular}{ll}
\hline
\textbf{Statement of Contributed Shareholders' Funds} & \\
\hline
Share capital & \\
\hline
\textbf{Paid in Capital} & Note 3 \\
\textbf{Less Funds invested in research, development etc.} & Note 4 \\
\hline
Top 20 shareholdings & \\
Substantial shareholdings & \\
Distribution of holders of ordinary shares & \\
\hline
\text{Number} & \text{Percentage} \\
< 1000 & \\
1000-5000 & \\
5000-10000 & \\
>10000 & \\
\hline
\end{tabular}
\end{table}

\textsuperscript{929} Suggested items here are consistent with data found in annual reports of listed corporations in Australia.
Statement of Changes in Contributed Share Capital

Balance at start of period
Share issue
Exercise of options under Executive Option Plan

Less share buy-back plan
Balance at end of period

Statement of Cash Flows for period
Cash flows from operating activities

Cash flows from investing activities

Cash flows from financing activities
Net increase (decrease) in cash held
  Cash at start of period
  Exchange rate adjustments
Cash at end of period

Notes to the Statements
1. Significant accounting policies
1a. Basis of Preparation
These statements meet a stewardship role by providing a summary of funds contributed by shareholders and cash flows of the entity during the stated period. These data meet requirements under selected regulations of the Corporations Act, 2001 and standards of AASB.

3. Share capital by type, par value, issue price etc.

4. Funds invested from Share Contributed Capital, while perhaps having economic future benefits, are not included in contemporary financial position as assets if no ready market is available. For disclosure purposes, the disposition of these funds is reported as shown (Chambers, 1980, p58; Bloom, 2005, p11).

9. Total of cash held at end of period:
  Cash on hand
  Deposits held
  Bank accounts

17. Reconciliation of profit from trading activities and net cash flows from operating activities.

  Reasons for differences identified.
(ii) Financial Statements

Statement of Contemporary Financial Position

Assets

Cash

Prepaid items
  Accounts receivable
  Inventory with a ready market
  Inventory without a ready market

Durable items with a ready market
Durable items without a ready market

Liabilities

Accounts payable
Bank overdrafts

Employee entitlements
Claims under dispute

Loans

Contractual amount

Shareholders' Equity

Paid in capital

Less selected sunk costs

Capital maintenance reserve
Retained profits

Statement of Retained Profits

Balance at start of period
Capital maintenance adjustment to opening balance
Profit (Loss) during period

Less Dividends Paid
Proposed

Balance at end of period

See Note 9 in (i)

Note 1b
Note 1c
Note 1d
Note 1e
Note 1d
Note 1e
Contractual amount
See Note 3 in (i)
See Note 4 in (i)

Suggested items here are consistent with selected data for some items found in annual reports of listed corporations in Australia; with Chambers (1966a, p256 & 250) where pro forma statements under CoCoA are suggested (but here adjusted to meet later refinements of Chambers); with Chambers (1970d, p646); with Chambers (1975); with Friedman (1978, p28-40) whose suggestions (to incorporate a separation in the performance report between holding and operating activities) tend to follow Chambers' earlier ideas; with Chambers (1980, p58 & p68-69).
Statement of Financial Performance

Revenue
From sales of merchandise or services
From sales of durables
From other investments

Expenses
Monetary amount at time of sale of
Merchandise
Durables
Price level adjustments to
Merchandise
Durables
Depreciation & Obsolescence
Purchase price of services etc
Capital maintenance adjustment

Profit from trading activities
Windfalls

Profit for period See Note 17 in (i)

Notes to the Financial Statements
1. Summary of significant accounting policies
1a. Basis of Preparation
These statements provide a summary of funds contributed by shareholders and by creditors with contractual relationships with the incorporated entity. Information on the investment of those funds in assets tradable in markets and of trading activities during the stated period under an accrual process is provided. The information supports decision-making by providing data of past and contemporary events of a financial nature and complies with requirements under selected standards and regulations.

1b. Prepaid items relate to contractual agreements (usually regarding services) for which monetary amounts from active markets are available.

1c. Accounts receivable are contractual amounts from sales on credit after the exclusion of actual bad debts.

1d. Items with a ready market are shown at the monetary amount of the exit price at the end of the period.

1e. Items without a ready market are shown at zero.
1f. Employee entitlements are shown at the contractual amounts owing at the end of the period. This may be calculated under a model which incorporates past and contemporary data; for example,

Employee’s long service leave entitlement (under contract) \( \times \) current pay rate.

1g. Claims under dispute may be disclosed but no monetary amount recognized until some contractual arrangement eventuated.

Financial Risk Analysis & Management including Key Financial Indicators

The corporation’s risk management approach is consistent with the Australia/New Zealand Risk Management Standard (David Jones Annual Report, 2005, p20-21). Included are qualitative and quantitative (both monetary and non-monetary\(^{931}\)) based on past and contemporary data.

(a) Qualitative

- Statutes, regulations, standards \textit{etc} with compliance requirements
- Financial strategies developed
- Control and monitor mechanisms set and applied
- Guarantees and Deeds of Cross Guarantee
- Conflicts of interest identified
- Segregation of financial duties
- Financial reconciliations identified and applied
- Physical security over assets

(b) Quantitative - monetary

- Trading ratios
  - Return on equity
  - Return on assets
  - Growth ratios - $ sales \textit{etc}
- Risk ratios
  - Current
  - Quick
  - Leverage

(c) Quantitative - non-monetary

- Trading ratios
  - Growth ratios - sales in physical terms \textit{etc}
- Risk ratios
  - Account receivable turnover in number of days
  - Inventory turnover in number of days
  - Compliance (in say days) with various financial regulations \textit{etc}

\(^{931}\) A plausible case may be made for these items to be included in either (iii) or (iv) rather than be seen as part of the Financial reports.
(iii) Economic Reports

Statement of Economic Position

Means (including Assets from ii)

Cash

Prepaid items

above

Accounts receivable

Inventory with a ready market

Inventory without a ready market

Durables with a ready market

Durables without a ready market

Obligations (including Liabilities from ii)

Accounts Payable

Bank overdraft arrangements

Employee entitlements

Claims under dispute, including expected warranty costs

Loans

Shareholders' Equity

Items from (ii) above

Residual amount

Statement of Economic Performance

Revenue from sales

Production output

Expenses

Cost of goods sold

Other production costs

Other items

Profit from trading

Other windfalls

Economic profit for period

See Note 9 in (i)

See Note 1b in (ii)

Note 1b

Note 1d in (ii) above

Note 1c

Note 1d

Note 1d

Note 1e

Note 1f

Note 1g

Note 1h

Note 1j

Financial Segment

Non-financial Segment

932 Suggested items here are consistent with selected data for some items found in annual reports of listed corporations in Australia; with data found in Systematic Software Intellectual Capital Report 2004; with data found in Waste Recycling Group Report on Corporate Responsibility 2003.

933 This may be based on a particular hybrid system which might include items under conventional accounting, financial ones as in (ii) above, CCA/RPA (Chambers, 1980, p96 & p101 and other expected or anticipatory items (Chambers, 1970c, p551-552). A reconciliation of certain amounts from the Financial reports and Economic reports would be possible.
Notes to the Economic Reports

1. Significant reporting policies

1a. Basis of Preparation
These statements support decision-making by providing data of past, contemporary and future events of a financial and economic nature. These data meet requirements under selected regulations governing the entity during the stated period.

1b. Accounts receivable are contractual amounts from sales on credit with an allowance for actual bad debts and expected doubtful debts. The allowance may be based on actuarial calculations (including a discounting factor) or on management experiences of past and current conditions and those expected in the future.

1c. These amounts may allow for expected costs of disposal – the net realizable calculation found in annual reports.

1d. Surrogates may be used for the monetary amount of these items under ‘fair value’ considerations (as met in Chapter 8).

1e. The monetary amount of items here would be at contractual amount, but may be adjusted to allow for a present value factor.

1f. Total amount available $ 
   Balance as per (ii) above $ 
   Amount unused $ 

1g. Employee entitlements would be based on the contractual amounts owing at the end of the period. However, it may be calculated under a model which incorporates past, contemporary and future data as found in actuarial models; for example, 

Employee’s long service leave entitlement x future pay rate x discount factor (to allow for inflation, life expectation and other possible events.

An economic value (and related gain) might be possible as it may be some time before the employee takes the leave, as met in various economic models in Chapter 8.

1h. Claims under dispute or warranties given may be disclosed but if a monetary amount was recognized, a discounting factor may be incorporated.

1j. The monetary amount of Loans may be at contractual amount, market price of any bonds or at a discounted present value amount.

Economic Risk Analysis & Management including Key Economic Indicators
The corporation’s risk management approach is consistent with the Australia/New Zealand Risk Management Standard (David Jones Annual Report, 2005, p20-21). Included are qualitative and quantitative (both monetary and non-monetary) data. As well, data from (ii) above may be incorporated.

(a) Qualitative
Statutes, regulations, standards etc of an economic type with compliance requirements (say Fair trading, Competition issues, Health & Safety)
Economic strategies developed
Planning processes developed
Related control and monitor mechanisms set and applied
Security over resources (including IT and other infrastructure items)

(b) Quantitative – monetary
  Exposure to interest rate risk
  Exposure to foreign exchange risk
Budgeting processes
Expected trading ratios
  Expected credit risk ratios
    Current ratio
    Quick ratio
    Leverage ratio
Value-added calculations
Regarding internal processes
  Cost of hours vested in process improvement
  Projects moved to higher levels – value
  Finished projects trend line – value
Regarding employees
  Employee turnover – training costs
Regarding customers
  Active project customers – value
  New project customers - value

(c) Quantitative - non-monetary
Compliance (in say days) with various economic-type regulations etc
Regarding internal processes
  Hours vested in process improvement
  Projects moved to higher levels – number
  Delivery time – in days
  Finished projects trend line - number
Regarding employees
  Number
  Employee turnover
Regarding customers
  Active project customers – value
  New project customers - value
(iv) Social Reports

Statement of Social Position and related Statement of Social Performance

Resources (including Means and Assets)
As per (ii) above
As per (iii) above
Human resources
Benefits from community relationships
Environmental resources
  Water
  Air
  Other

Responsibilities (including Obligations and Liabilities)
As per (ii) above
As per (iii) above
Human resources health and, workplace responsibilities
Community responsibilities
Environmental responsibilities
  Water
  Air
  Other

Notes to the Social Reports
1. Basis of Preparation
These statements support decision-making by providing data of past, contemporary and future events of a financial, economic and social nature. These data also meet requirements under selected regulations (local, state, national and international) governing the entity during the stated period.

Social Risk Analysis & Management including Key Social Indicators
The corporation's risk management approach is consistent with the Australia/New Zealand Risk Management Standard (David Jones Annual Report, 2005, p20-21). Included are qualitative and quantitative (both monetary and non-monetary) data. As well, data from (ii) and (iii) above may be incorporated.

(a) Qualitative
  Statutes, regulations, standards etc of a social type with compliance requirements (say Community Health & Safety, Hazardous goods, Environmental & pollution issues)
  International conventions followed (say UN Human Rights)
  Social strategies developed

934 Suggested items here are consistent with selected data for some items found in annual reports of listed corporations in Australia; with data found in Systematic Software Intellectual Capital Report 2004; with data found in Waste Recycling Group Report on Corporate Responsibility 2003.

935 Arguably, although sections of these reports can be quantified, the major thrusts of these data are best reported qualitatively. Any addition or subtraction is done with extreme caution.
Planning processes developed
Related control and monitor mechanisms set and applied

(b) Quantitative - monetary
Donations to community groups
Contributions to community protective services
Costs incurred in dealing with pollution issues
  Regarding employees
    Costs of *ex gratia* payments
  Regarding customers
    Costs of *ex gratia* payments
Regarding community interests
  Greenhouse Gas generated per revenue unit
  Energy consumed per revenue unit
  Transport fuel consumed per revenue unit

(c) Quantitative - non-monetary
Compliance (in say days) with various social-type regulations *etc*
  Regarding employees
    Levels of education achieved
    Identified career paths
    Commitment and loyalty index
    Employee satisfaction
  Regarding customers
    Customer satisfaction
Regarding community interests
  Greenhouse Gas generated
    - by business units
    - source
Appendix V
Glossary of abbreviations and acronyms

AAA American Accounting Association
AAP Accepted Accounting Principles
AAPA American Association of Public Accountants
AARF Australian Accounting Research Foundation
AAS Australian Accounting Standards
AASB/AASC Australian Accounting Standards Board/Committee
AcB/AcSB Accounting Board/Accounting Standards Board
AIA American Institute of Accountants
AICPA American Institute of Certified Public Accountants
APB Accounting Principles Board
APRA Australian Prudential Regulation Authority
ARB Accounting Research Bulletin
ARF Accounting Research Foundation
ARS Accounting Research Study
ASA Australian Society of Accountants
ASC Australian Securities Commission
ASIC Australian Securities and Investments Commission
ASOBAT A Statement of Basic Accounting Theory
ASRB/ASRC Accounting Standards Review Board/Committee
ASSC Accounting Standards Steering Committee
ASX Australian Stock Exchange
ATB Accounting Terminology Bulletin
AuASB Auditing and Assurance Standards Board
CAP Committee on Accounting Procedures
CAS Complex Adaptive System
CAT Committee on Accounting Terminology
CCA Current Cost Accounting
CEO/CFO Chief Executive/Financial Officer
CF Conceptual Framework
CG Corporate Governance
CGB City of Glasgow Bank
CLERP Corporate Law Economic Reform Program
CoCoA Continuously Contemporary Accounting
CSR Corporate Social Responsibility
DPV Discounted Present Value
ED Exposure Draft
FASAC Financial Accounting Standards Advisory Committee
FASB Financial Accounting Standards Board
FDR Franklin D Roosevelt
FIFO/LIFO First/Last in, First/Last out
FTC Federal Trade Commission
FRB Federal Reserve Bank
FRC Financial Reporting Council
GAAP Generally Accepted Accounting Principles
GFS Government Finance Statistics
GRI Global Reporting Initiative
HCA Historical Cost Accounting
<table>
<thead>
<tr>
<th>Acronym</th>
<th>Description</th>
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<tbody>
<tr>
<td>IASB</td>
<td>International Accounting Standards Board</td>
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<tr>
<td>IASC</td>
<td>International Accounting Standards Committee</td>
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<tr>
<td>IBAA</td>
<td>The Investment Bankers Association of America</td>
</tr>
<tr>
<td>IC</td>
<td>Industrial Commission</td>
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<tr>
<td>ICA/ICC</td>
<td>Interstate Commerce Act/Commission</td>
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<tr>
<td>ICAA</td>
<td>Institute of Chartered Accountants in Australia</td>
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<td>ICAEW</td>
<td>Institute of Chartered Accountants in England and Wales</td>
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<tr>
<td>IFRS</td>
<td>International Financial Reporting Standards</td>
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<tr>
<td>IMC</td>
<td>International Match Corporation</td>
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<td>JP</td>
<td>John Pierpoint Morgan</td>
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<tr>
<td>K&amp;T</td>
<td>Kreuger &amp; Toll</td>
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<tr>
<td>L&amp;GF</td>
<td>London and Globe Finance Corporation</td>
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<td>LIC</td>
<td>Legislative Investigating Committee</td>
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<td>LRB</td>
<td>Legislation Review Board</td>
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<tr>
<td>LTCM</td>
<td>Long Term Capital Management</td>
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<tr>
<td>MIS</td>
<td>Management Information System</td>
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<tr>
<td>NCSC</td>
<td>National Companies and Securities Commission</td>
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<td>NYSE</td>
<td>New York Stock Exchange</td>
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<tr>
<td>OECD</td>
<td>Organisation for Economic Cooperation and Development</td>
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<tr>
<td>PAT</td>
<td>Positive Accounting Theory</td>
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<td>PSASB</td>
<td>Public Sector Accounting Standards Board</td>
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<tr>
<td>RoAP</td>
<td>Recommendation on Accounting Procedure</td>
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<tr>
<td>RMSP</td>
<td>Royal Mail Steam Packet Company</td>
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<tr>
<td>RCVM</td>
<td>Relative Current Value Model</td>
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<tr>
<td>SAC</td>
<td>Statement of Accounting Concepts</td>
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<tr>
<td>SEC</td>
<td>Securities and Exchange Commission</td>
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<td>Statement of Financial Accounting Concepts</td>
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<td>SMC</td>
<td>Swedish Match Company</td>
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<td>UIG</td>
<td>Urgent Issues Group</td>
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<tr>
<td>TC&amp;I</td>
<td>Tennessee Coal and Iron</td>
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<tr>
<td>UK</td>
<td>The United Kingdom</td>
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<tr>
<td>USA</td>
<td>The United States of America</td>
</tr>
<tr>
<td>WW</td>
<td>World War</td>
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Appendix VI
Summary of Arguments

As pointed out in 1.5, the development of the Argument is found in the Summary and Conclusions in Chapters 2 to 8 inclusive. Four themes evolved as the study progressed and in this Appendix the total Argument is reproduced. Of the three number classification used, the first number refers to the Chapter; the second to the particular theme; the third to the point of interest.

Theme 1. Identification of selected general issues.
2.11 Relationships among individuals and groups required an accounting.
2.12 Relationships among individuals and groups required a governance framework.
2.13 Debates occurred regarding applications of ideas in practice.
2.14 Limited debate occurred regarding the philosophy underlying practice.
2.15 An integral relationship was that with the steward.
2.16 Within manor-type relationships, a narrow scope of stewardship sufficed.
2.17 Stewardship required recording and bookkeeping; reporting; checking and auditing.
2.18 As commerce/mercantilism grew, also did relationships among stakeholders who required a broader scope of stewardship.

3.11 Corporate management tended towards a view of confidentiality and secrecy, demanding more latitude in reporting.
3.12 Selected other stakeholders demanded greater publicity.
3.13 Selected other stakeholders demanded increased regulatory overview, perhaps under uniform applications and reporting.
3.14 Self-regulatory processes, including 'the market', debated.
3.15 'Moral regeneration' was suggested as a solution to overcome various questionable practices.
3.16 Personal qualities, like training and heritage, were raised as potential regulatory processes, including via professional development of standards.

4.11 Publicity regarding financial information continued to be debated.
4.12 Management continued to be given discretion and scope to manage information on income.
4.13 Government policies seeking investment in tangible assets were undermined by economic issues which resulted in higher returns from investment in non-tangible assets.
4.14 Self-regulation by co-operation among private groups is the preferred method of control.
4.15 It is argued that in accounting, commercial/financial needs are distinct from economic needs.
4.16 While at first speculation is seen as cause of economic and social difficulties, later revelations see questioning and criticism of accounting.

5.11 Growth occurred in people's capitalism via direct investment in shares of a corporation and indirectly as creditors, employees or consumers.
5.12 Growth occurred in investment in shares via the expansion of pension and superannuation funds.
5.13 Much discretion still remained for the application of 'judgment by management', especially regarding 'publicity'.

6.11 The accountability of directors/management to other stakeholders was questioned.
6.12 Debate on the meaning of a qualitative standard like the phrase 'true and fair view' continued.
6.13 The technical interpretation of a qualitative standard was promoted by some accountants.

7.11 Granting of legal backing for AAS increased the power of lawyers who had formerly played the major role in 19th Century (Chapter 2).
7.12 Lawyers’ arguments would be based on what is actually written in a particular AAS.
7.13 Developments continue beyond reporting of financial information, especially under environmental reporting.

8.11 Tensions continue on the definition of accounting.
8.12 Tensions occur between GAAP and legal terminology.
8.13 Tensions were created by development of new items like derived financial instruments.

**Theme 2. Incorporation of ideas of CG and choice,**
2.21 Formation of companies was through 'private' contracts initially between King or Queen and the proprietors and later between State and the proprietors.
2.22 Formation of companies became more 'public' when general incorporation by registration was introduced.
2.23 Investors required strict guidelines as protection from abuse by promoters and management.
2.24 Unlimited liability was used as a governance tool.
2.25 Economic growth and large scale investments were facilitated by joint stock companies incorporated through general registration – subject to as quid pro quo publicity provisions – and later with limited liability, providing legal protection of investors which continued to be required.
2.26 Management became independent of owners and a stakeholder in its own right.
2.27 In a context of a management-stakeholders (mainly shareholders and selected creditors) relationship, the accountants adopted a narrow stewardship role without much reference to a decision-making role.
2.28 A link was forged between managerial control and finance houses.
2.29 Publicity in general and publicity of financial information in particular were seen as governance tools.
2.29a Management sought discretion in reporting.
2.29b The idea was floated that disclosure by honest corporations could be used as a standard for uniform rules of disclosure.

3.21 The corporation is analysed more as an economic organisation relative to the previous legal approach.
3.22 Argument is made for reporting selected risk factors.
3.23 The ability of investors to interpret corporate financial statements is questioned.
3.24 Effort tends to be expended on issues of format at the expense of questions of principle.
3.25 Quality of information produced and links to issues like format – the substance-over-form argument - are not explicitly established.

4.21 The corporation is accepted as a key economic device, tilting the balance away from social issues.
4.22 Issues of form tend to dominant those of quality.
4.23 After the 1929 Crash and the following depression, public mood changes towards the need for legislation.

5.21 The corporation in USA became a social construct as well as being previously an economic one.
5.22 Data sought for CG and choice were not necessarily of a financial type.

6.21 The role of accounting reports in any accountability of directors was questioned.
6.22 The use of dated figures in accounting reports with the potential to mislead investors was questioned.
6.23 The need for stakeholders to receive contemporary financial data in reports if to be used in decision-making.

7.21 Developments continue beyond reporting of financial information, especially in CG Statements.

8.21 Conventional accounting –May’s legacy - was still seen to have a function in CG.
8.22 The ‘total scene’ in choice was seldom introduced in debates on or criticisms of CoCoA.
8.23 At the application level, tensions arose which suggested a need for reports distinct from financial ones.

Theme 3. Incorporation of issues of accounting in general
2.31 Accounting professional groups were established.
2.32 Conventions found in practice were supported and applied by accountants.
2.33 Conventions were practiced to meet tensions regarding the determination of income.
2.34 The qualitative standard ‘full and fair’ (now ‘true and fair’) was not explicitly linked to accounting conventions.
2.35 A boom-crisis-boom cycle was established where questionable reporting practices from corporations led to a scrutiny of accounting methods and practices.
2.36 Stakeholders other than shareholders and management are affected by the actions and reporting by management of corporations.
2.37 The continuity of corporations gave rise to a going-concern valuation of assets.
2.38 A link between crises/financial collapses and a need for reform of accounting reports to provide better quality information was forged.

3.31 Accounting professional groups face emerging institutional tensions.
3.32 Accounting professional groups make submissions to inquiry committees.
3.33 Some effort is expended on underlying reasoning of accounting (an academic approach) relative to issues of application.
3.34 Sprague introduces the notion of reciprocity which has implications for identification and measurement debates on assets and liabilities.
3.35 Fisher introduces economic ideas of future expectations and discounted values which are to be applied in accounting - a going-concern valuation.

4.31 Limitations of the output of accounting are stressed under May Legacy.
4.32 Technical meanings and conventions adopted in accounting.
4.33 Under May Legacy, non-accountants are to be educated regarding matters like these.
4.34 Under May Legacy, personal qualities are seen as the solution of problems in accounting.
4.35 Some like MacNeal argued the problem was not a moral one but an intellectual one.
4.36 Findings from investigations into collapses see mood for legislation including that on accounting, strengthened.
4.37 The income statement is deemed the dominant statement.
4.38 Tension grows among those in the practitioner and in the academic wings of the profession.

5.31 Was the stated recipient of a balance sheet a lay-person or a technical person?
5.32 Questions were raised in Australia in a ‘Revaluation of Accounting’ at both the institutional and information levels.
5.33 Lacking underlying reasoning based on logical premises, problems in reporting continued to be approached in a case-by-case manner.
5.34 Data of social and economic type seemed intermingled with that of a financial type.
5.35 Questions were asked like ‘What was “reasonably objective” evidence’?

6.31 Whether accounting in principle differed among types of entities (especially between corporations and individuals) was debated.
6.32 Whether terminology was to differ among types of entities.
6.33 The variability of GAAP and selected practices in accounting continued to cause concern.
6.34 How were related principles/standards/rules to be developed?
6.35 Who was to develop those principles/standards/rules?
6.36 Whether and how contemporary monetary amounts of assets might be incorporated.
6.37 Whether and how to incorporate changes in these contemporary monetary amounts in determining income.
6.38 Whether and how to incorporate changes in price levels in general in determining income.

7.31 The various blocks/levels of the CF highlighted potential argument among those levels.
7.32 Debate continued on the rate of change from conventional accounting.
7.33 Radical change was resisted, especially by preparers of reports and management.
7.34 SACs have a rocky existence as one is still to be developed for Block 1, major resistance was found to SAC 4 and SACs regarding Blocks on measurement were to see a lengthy gestation period.
7.35 Inconsistencies among accounting standards and the CF continue.
7.36 Muted criticism is offered of accounting data as arguably the CF project is seen to have improved AAS.
7.37 Criticism was concentrated on personal qualities of individuals, including accountants.
7.38 Few academic accountants debated the quality of financial information.

8.31 Tensions continue to occur in terminology used under GAAP in general.
8.32 By conventional accounting dealing with 'costs' and their allocation, measurement issues were inherently included in issue of identification or definition.
8.33 Attempts to include notions from measurement proper like
* the identification of a property debate or
* additivity in the physical sense debate
seemed to have
* little effect on applications by practitioners and
* an ability to derail proposals (like CoCoA) to change conventional accounting.
8.34 Various attempts were made to account using some form of 'current value', especially in times of high inflation.
8.35 Chambers' CoCoA was seen as a radical change from conventional accounting.
8.36 Alternatives to conventional accounting measures (and CoCoA) included deprival value.
8.37 Alternatives to conventional accounting measures (and CoCoA) included fair value.
8.38 Debate was found on whether fair value differed from deprival value.

Theme 4. Incorporation of issues of liabilities in particular.
2.41 A legal bent identified liabilities.
2.42 Liabilities tended to be shown at a legal, nominal amount.
2.43 A distinction was forged between legal and moral obligations.
2.44 New practices like the open-ended mortgage, while not affect the reporting of liabilities, had implications for the reporting of the amount of that liability.

3.41 Sprague provides reasoning underlying issues concerning liabilities.
3.42 Actuarial assessments are well established with potential application in accounting in general and for liabilities in particular.
3.43 Some suggest a 'third place' on the equity side of the balance sheet.

4.44 Liabilities continued to be debated mainly at the application level, though some in the academic wing related sought underlying reasoning.
4.45 Debates on liabilities included issues of definition and monetary amount.

5.41 A clear distinction was suggested between identification/recognition and measurement of liabilities.
5.42 Treatment of selected items with interactions for liabilities, like pension plans and leases, produced tensions for reports under conventional accounting.

5.43 New financial instruments provided difficulties for classification as either liability or owners' equity, leading to suggestions for a third element on the equity side of the balance sheet.

5.44 What was the connection, if any, among terms like 'obligations', 'liabilities', 'claims' and 'debts'?

5.45 What was 'an established burden' and how might it be related to 'reasonably objective evidence'?

5.46 How were 'improbable and conjectural claims' to be made operational?

6.41 Whether and how contemporary monetary amounts of liabilities might be incorporated.

7.41 Liabilities arising from legal and social grounds intermixes two distinct issues, with interactions for financial ones.

7.42 The time frame adopted in CFs introduced anticipatory issues which led to tensions.

7.43 The degree of estimation allowed in the reporting of liabilities led to tensions in measurement (See Chapter 8).

7.44 Liabilities are to be recognised in principle in the balance sheet, but tensions remain from application difficulties seeing their recognition in notes or other parts of the annual report.

8.41 Tensions continue to occur in terminology used under GAAP for liabilities in particular.

   Conventional accounting still supported a carrying value which could be determined in various ways.

8.42 Chambers continued to support 'contractual amount' to determine the monetary amount of a liability.

8.43 Under CoCoA, face value, market trading price or discounted present value did not provide the monetary amount for financial position purposes; that was not to argue that these other values or prices were irrelevant in decision-making or choice.

8.44 Deprival value for liabilities was seen to encourage a mixed-value approach.

8.45 Debate was found on the application of fair value techniques.
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357


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383


