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Financial accounting and reporting in the United States of America – 1820 to 2010

Toward sunshine from shadows

Gary J. Previts and Dale L. Flesher

Foreword

The Treaty of Ghent (Belgium) signed on the eve of Christmas in 1814 and the contemporaneous battle of New Orleans and victory attributed to General Andrew Jackson ended an episode in United States history that can be considered an anticlimax to the American Revolution. To many who doubted the ability of the fledging republic to survive another contest with Great Britain, the outcome of the War of 1812 made further apparent the ability of the young nation to survive and, soon, to prosper. The acquisition of territories under the Louisiana Purchase of 1803 laid out a country that would be a continental one. These defining events of the early nineteenth century, along with developments such as the opening of the Erie Canal (1825) and the chartering of the Baltimore and Ohio (B&O) Railroad (1827), shaped the beginning of a distinctive American Business System. For these reasons, 1820 becomes a meaningful choice to begin this writing.

This essay explicates and discusses historical, regulatory, socioeconomic, and political factors that are considered to have influenced the changes in accounting thought and practice in the United States over nearly two centuries. These factors, including the key role of individuals, will be roughly subdivided into two broad periods – namely the period before 1920 and the period thereafter. The choice of 1920, while arbitrary, reflects changes in the aftermath of World War I, wherein the US economy was transformed from a mainly agricultural one to an industrial one and the US became a creditor nation in contrast to its previous status as a debtor developing economy. Between 1820 and 1920, the country’s demographics changed from a population of slightly under 10 million, including 1.6 million slaves, with voting limited to males, to a population of 308 million individuals, the adult population of which had the right to vote. Many measures were developed during this period to determine the size, direction, and scope of the economy. From an investment perspective, perhaps none has gained more attention than the Dow Jones Industrial Average (DJIA), established in May 1896, which serves as a broad barometer of the prospects and mood of the equity markets, if not the entire economy.
The DJIA is both a metric and a symbol of the equity portion of an investment culture that has been a dynamic component of the American business system and capital formation. The DJIA forms and shapes the demand for information provided by a profession of preparers, auditors, and analysts who have similar, common, or licensed education attainments; a certified professional credential is involved as well as a claim toward public responsibility. Just as the economy has changed, so too have the DJIA components changed dozens of times over the years since its inception. At its inception, it included twelve stocks; today it includes thirty, and only one, General Electric, remains from the original group. On its first day, the DJIA closed at 40.94, and by August of that year it was down to 28.48, a 30 percent decline (Gordon, 2000, p. 171). At the end of 2010, the DJIA closed at 11,577. At the trough of its post-2008 period, at the end of February 2009, the index was just above 7000. During a decade-long period of “irrational exuberance” during the 1990s, the DJIA sprinted from a 1990 opening of 1,273 to a December 1999 month-end close of just under 11,500. Indeed, the DJIA and the market capitalizations of bonds and stocks have grown substantially over the period in question and provide background for why the controversy over the purpose of accounting and financial disclosure has become so vibrant and challenging a topic.

This essay identifies and describes episodes in the development of US accounting thought and practice, including events and activities from a time when accounting was based on the content of early popular books and manuals through a period of original regulatory activity involving the development of large railroads, to a period of common law influence up to the current period when codification has been adopted as a central form of organizing accounting thought – that is, wherein accountancy may be seen as a regulated activity with its own form, seeking a type of conceptual coda. The time frame of this chapter concludes at the end of the year in which the Financial Accounting Standards Board (FASB) issued its most recent non-authoritative statement of conceptual guidance, Financial Accounting Concepts Statement No. 8 (September 2010). Over the preceding two-century period, the United States emerged from its infancy as a commercial and industrial nation and a federation of individual states to become demonstrably the most successful sovereign national economic colossus of any era, affecting the lives and livelihood of not only its citizens but also a global community of billions.

And so, what are the important episodes and aspects of accountancy in this period? Is a philosophy of “American pragmatism” in accounting thought an explanatory element in this development? Is a regulatory maxim of “sunshine” a prominent framework as a social remedy between the public and large economic entities that deploy major amounts of capital in the economy? While this essay does not seek to respond specifically to such framing questions, they serve a valuable point from which to begin any consideration of the development of accounting thought during this period.

The notion of “sunshine” or “disclosure” – or as it is more popularly called today, “transparency” – implicitly provides an objective for the discipline, which leads over time to public reporting, beginning in the post–Civil War period as a response to corporate industrialism and continuing to today’s global capital sourcing and markets. Accounting itself, however, precedes this emphasis on publicity and was focused principally on stewardship or control over assets, with the information being proprietary to the individual or a limited group of individuals in ownership roles. Broad public participation in capital markets over the period of study has shifted sentiment as to the role of both financial accounting and reporting. As well, the role and identity of the community of practitioners who provide accountancy services and claim the status of a profession has transformed in significant ways. Awareness of how a “sense of purpose” of this group is understood in previous and current political and economic times seems
important to the intellectual identity of accountancy as a discipline. For example, the initial legal recognition and licensure of the Certified Public Accountant (CPA) under state law in New York in 1896 fostered a movement that includes similar legislation in all other US states and territories and corollary non-licensed certifications in specialty areas. Until the 1920s, a high school diploma was sufficient to meet the educational requirement, and over the ensuing decades the requirement has changed first to a college degree and now to a post-baccalaureate degree, most commonly a professional fifth-year degree. During this time, the population of CPAs has grown from a handful to fewer than 10,000 at the time of World War II to over 400,000 today. Similar growth in non-licensed certifications, identified prominently with the post-1970s period, has also taken place.

**American accountancy thought, 1820–1920: merchants and countinghouses (Cronhelm, Marsh, Bennett, Jones, and Foster)**

The purpose of this chapter is to establish a common and dominant set of ideas about what might be identified as stages through which financial accounting and financial reporting developed in the United States. No single attempt can be complete or comprehensive, of course, since no single expression of a complicated past can be told from all points of view at one point in time. The story begins during the early period of the American republic when the physical domain was only beginning to reflect the added geography of the Louisiana Purchase of 1803, which enlarged the dimensions of the nation as a country that was now developing on a major continent. By the 1730s, the activities of the merchant in the American colonies were identified with the “countinghouse” or “compting house,” wherein the merchant directed many operations (Previts and Sheldahl, 1977). At the end of the eighteenth century, the focus shifted to the earliest known US published book on accounting, Benjamin Workman’s *The American Accountant* (1789). However, since that publication was somewhat of an outlier, a more appropriate starting point is deemed to be 31 years later in the period of “rote” bookkeeping based on double entry. This was a time of pioneering writers such as James Arlington Bennett, who is identified as an early influence due to a visual device, the “balance chart,” provided as a fold-out, double-page illustration in his 1820 work, *The American System of Practical Book-Keeping: Adapted to the Commerce of the United States*. The chart is a framework depicting the manner in which debit and credit accounts were kept and the details of the merchant’s “leger” of an organization. Pages ix to xi describe the classes of accounts and the “General rules for Dr. and Cr.,” identifying those actions for “real accounts,” such as, “When a thing becomes mine it is a Dr.; When it costs me any thing it is a Dr.; When it ceases to be mine it is a Cr.; When it brings me in any thing it is a Cr.,” and so on. These rules are the basis for the lectures captured in the book and are indicative of the rote guidance, or what might now be called a “rule-based” system, for how to treat transactions in the setting of the mercantile economy of the early American system of business. At the chosen point of departure, Bennett’s work is representative of this era of mercantile/proprietary capitalism and is arguably sufficient, but there were many other important authors, including Turner (1804), Sheys (1818), Jackson (1801), Lee (1797), Marsh (1831), and Colt (1838). Scholarly reviews of many of the works of this Mercantile Era are found in the 25-volume set covering the years from 1796 to 1887 edited by Williard E. Stone and published in 1982 in the Yushodo American Historic Accounting Literature Collection. Stone provides an introduction to each of the 25 volumes, placing their content in perspective and adding to the understanding of how early practices were written about and taught throughout the nineteenth century.
"Two-account series" era, proprietary books, and schools

The development of the technical double entry system of transaction accounting in the early nineteenth century permitted accounting activity to be redefined, as the proprietor’s countinghouse evolved into the office of the business in a more open, albeit still non-public, manner. In particular, Thomas Jones (1841) and his copying-synthesizing contemporary, Benjamin Franklin Foster (1836), are recognized as beginning the period of defining recognition of “primary” and “secondary” accounts, which evolved into the process that differentiates the balance sheet (primary) and income (secondary) statements. In a paper by Henry Rand Hatfield translated from an early German-language writing, Jones’ advocacy of the two-account series view of record keeping is identified as predating similar work being undertaken by prominent writers in Germany and Switzerland in the mid-nineteenth century (Homburger and Previts, 1977). This simple but profound distinction in accounts by Thomas Jones of the United States (Book-keeping and Accountantship, 1849) and the advocacy of Foster in promoting the notion in propriety textbooks of the time advanced the preparation of balance sheet and income statement forms to support the process of external communication beyond the domain of the individual proprietor. And as Chatfield (1974, p. 72) observes, it was when the preparation of statements became the main purpose of bookkeeping, supplanting the owner’s private use of ledger information, that amounts became further “refined to more closely approximate current market prices.” The phrase “keeping the books” henceforth would denote an increased expectation for financial statements that resulted from a broader, more publicly responsive thought pattern or, to use a contemporary term, a “framework” as to an expected end product of the accounting process. Bryant, Stratton, and Packard, who were active promoters of early so-called proprietary schools of business, as universities had not yet extended academic recognition to the field, taught the rules or rote of this process and reached not only all the major cities in the United States but also overseas areas, including Japan. The language of “For” and “By” to indicate which account received which entry evidenced the emphasis toward a rote approach to teaching bookkeeping. This was a slight advance from Bennett’s “General Rules for Dr. and Cr.” of the Mercantile Era.

Algebraic foundations, sunshine, and uniformity (Adams, Sprague, Dickinson, and Hatfield)

Bryant, Stratton, and Packard’s texts in the 1860s explicated and advanced these general rules and other notions within the commercial education establishment needed to support the new accounting workforce and to deal with the business and capital market developments instigated by the industrialization of the Civil War and post–Civil War era. Charles Ezra Sprague’s four-part series in exposition of “The Algebra of Accounts,” first published in The Book-keeper in July and August of 1880, presented the beginnings of a proprietary theory by establishing the mnemonic rationale for a transaction-based accounting “equation” as a foundation of practice, expressed then as “What I Have + What I Trust = What I Owe + What I am Worth” or “Assets = Liabilities + Proprietorship.” A fuller expression of proprietary theory’s “conceptual framework,” as it would today be called, was Sprague’s privately published work, The Philosophy of Accounts (1907). As a faculty member of the newly formed School of Commerce, Accounts and Finance of New York University, Sprague was ideally situated to propagate this important intellectual view. His influence was not limited to the commercial center of New York; his Philosophy was read by other early accounting academics, including Henry Rand Hatfield and William A. (Bill) Paton, and application and debate about proprietary theory expanded rapidly.
Both Hatfield and Paton provided testaments to this influence in the foreword to the 1922 Ronald Press reprint of Sprague’s *Philosophy of Accounts*.

These advances in the stewardship role of accounting and the subsequent developments in reporting within the proprietary view were significantly affected by the expanding network of capital sources beyond the resources of a single capital provider and by the increasing influence of state agencies that began to oversee the numerous corporate entities that were enlarging the industrial base of the economy with their highly scaled activities, with railroads being a prominent example. From the mid-nineteenth century forward, Chatfield (1974, p. 72–73) identified “American Financial Reporting” as being in a nascent stage demonstrating a pronounced liquidity and banker doctrine. In 1894, the predecessor of the American Institute of CPAs (AICPA) adopted a resolution that seems to be the first professional standard; it required that the balance sheet should be presented in order of the quickest realization, thereby achieving a focus of liquidity (AIA, 1938, p. 6). Railroad regulation, notably by state commissions, began to involve matters of public safety, but due to the influence of Charles Francis Adams, Jr., the grandson of one president and the great-grandson of another, the economic impact of these large corporations soon became a focus. Adams, as the head of the Massachusetts Railroad Commission in the years following the War Between the States, prominently championed the concept of full disclosure. He called the concept sunshine, and his agency became known as the Sunshine Commission. Adams called for railroads to report information, including non-financial disclosures that might involve issues of public safety, in a manner that would improve the general public’s understanding of the function and performance of these entities. In the ensuing years, Adams marshaled and supported an expanding effort among regulators from many other key states and, as reported in the *New York Times* (November 13, 1878), agitated for a “special committee” to be appointed to consider the subject of accounts and a system of “uniform railroad book-keeping” (Brearey and Previts, 2013).

These efforts eventuated from the growing popular unrest as to the nature of corporations and the belief that disclosure would provide some remedy for concerns by way of informing the general public. Indeed in 1887, upon the establishment of the first major federal regulatory agency, the Interstate Commerce Commission (ICC), the reporting requirements established for interstate carriers followed those developed by the states, resulting in volumes of information prepared and ultimately utilized as the basis for early attempts at security analysis by individuals including Benjamin Graham (Graham, 1986, p. 50). The recognition of such a special role for publicly available information and use of disclosure as a social response and remedy for secretive corporate activity subtly and perhaps silently exists as a fundamental objective of contemporary corporate reporting. “Uniformity” was one of the most desirable aspects of sunshine, a notion that the ICC experimented with throughout the early progressive years of the Woodrow Wilson administration in the twentieth century. The concept of disclosure would be adapted following the writings of Berle and Means in the 1930s (*The Modern Corporation and Private Property*, 1933). The British view of “True and Fair Disclosure” was displaced by the ideal of “Full and Fair Disclosure” to address agency problems once the Securities Acts of the 1930s were enacted.

**Contributions of the railroads**

Miranti and Goodman point out that the “railroad accounting model” developed in the nineteenth century as a response to the information needs of three groups (1996, p. 487). The first group was management – the railroad managers who utilized cost data to operate the railroads, controlling people and equipment across a wide geographical area in which a close schedule and a
single-track system required careful coordination. The second set of users of accounting information were the investors who had provided unprecedented amounts of capital to build the rail lines. This group needed information to evaluate stock and bond investments. Given their outside position, these providers of capital also had to monitor the railroad managers. Finally, railroad accounting was shaped by regulators at the state and national levels, who sought accounting information in order to understand costs and thereby address rates charged for freight and passengers. The railroad accounting model dominated the nineteenth century and influenced capital-intensive industries, such as the steel industry, utilities, and manufacturers, that were seeking capital to develop.

Previts, Samson, and Flesher have extensively examined the US railroads prior to the Civil War for their contributions to the development of accounting and auditing. In a 2000 *Accounting Historians Journal* article, the authors analyzed the content of 25 years of B&O annual reports to trace the development of annual reports, their content, and the evolution of financial statement format (Previts and Samson, 2000). A similar article in 2006 addressed the same issue at the Illinois Central Railroad (Flesher et al., 2006). Papers that explore auditing of American railroads include “The Origins of Value-for-Money Auditing” (Flesher et al., 2003) and “Auditing in the United States: A Historical Perspective” (Previts et al., 2005). These papers examine the use of the audit committee by directors of railroads. The public interest dimension of US railroads was examined in “Accounting, Economic Development and Financial Reporting: The Case of Three Pre-Civil War US Railroads,” published in *Accounting History* (Previts et al., 2003). The problems of income measurement of nineteenth-century railroads was examined in “Quality of Earnings: The Case of the Mobile and Ohio Railroad,” published in *Issues in Accounting Education* (Samson et al., 2003).

In another case, also published in *Issues in Accounting Education*, the authors examined corporate governance and the raising of capital from external investors during the early years (1831) of the B&O Railroad (Samson et al., 2006). In “Reporting for Success,” published in *Business and Economic History*, the managerial accounting information developed and utilized during the developmental stage of the B&O is described (Samson and Previts, 1999). This issue is further explored for its cost accounting contributions in “Using Accounting to Manage” in *Accounting and History* (Flesher et al., 2000). In “The First CPAs of 1896–97,” published in *Business and Economic History*, Flesher, Previts, and Flesher profiled the early CPAs that started the US accountancy profession, a group that included C. W. Haskins and E. W. Sells, both of whom were former railroad accountants (1996). With respect to financial statements, an article by Rosen and DeCoster (1969) attributed the invention of the cash flow statement to the nineteenth-century railroads. These citations provide examples of railroad innovations, including the format and content of annual reports; the measurement of income with depreciation of long-lived assets becoming not only a theoretical but also a pragmatic issue; the standardization of accounting methods and accounts to aid regulators; the concept of retained earnings being a source of capital; and the use of internal auditors, controllers, audit committees, vouchers, and controls over cash. The managerial accounting concepts of fixed costs and variable costs and the impact of efficiency (throughput) on the profitability of large-scale, capital-intensive businesses were learned at the railroads and later applied in heavy manufacturing. The essence of the preceding articles and others is that the railroads played a major role in the development of accounting in America. Detailed historical study of railroading involving primary archival records as to practice and policy has been a development of recent decades.

**Uniform accounts**

Seeking uniformity in sunshine reporting began with the railroads following the Civil War and was accepted perhaps because it was deemed as desirable, achievable, and beneficial. Meetings in Columbus, Ohio, and Saratoga, New York, in the 1870s and 1880s led to considerable
uniformity among railroads. This pursuit of uniformity was abetted by the passage in 1887 of the Interstate Commerce Commission Act, which later adopted uniform reporting requirements for railroads and other means of transportation. The ICC was influenced by the “Saratoga Classification” of state regulators until 1907, when ICC regulations ended the significance of that classification (Berger, 1947, Ch. XII). Nevertheless, accounting’s “framework” – if that is what it is called – continued its trend toward uniformity.

A set of events in the early twentieth century signaled the developing influence of Arthur Lowes Dickinson, head of Price Waterhouse in the United States. In an address to the First World Congress of Accountants in St. Louis in 1904 on the subject of a profit and loss statement, he presented his outline of what was to become the income statement format recommended a decade later as part of a set of uniform information guidelines to be required by banks. In an action taken by the newly initiated Federal Reserve Board (FRB) in the April 1917 Federal Reserve Bulletin, the Board members identified the characteristics of Uniform Accounts to be used to guide banks in making financial lending decisions and also as guidance for the Federal Trade Commission in its pursuit of uniform information from corporations regarding managing its mandate to assure a competitive economy. The income statement format found in this release mirrored the profit and loss statement outlined by Dickinson; indeed the disclosures were heavily influenced by his firm in its advice to the FRB (Allen and McDermott, 1993, p. 51).

Uniformity of disclosure to benefit bankers won support, but also contending for importance was the model of annual reporting influenced, if not developed, by George O. May, also of Price Waterhouse & Co., in the reports of United States Steel. The depth and breadth of detail disclosed in these annual reports can be described as iconic. They exemplify, according to Carduff, the stewardship model of reporting, reflecting the view of the Morgan Bank that the first US billion-dollar corporation would best serve its own interests by providing a model for appropriate industrial disclosure (2013). For decades thereafter, until the 1990s when institutional investors firmly and finally displaced individual investors as the principal source of direct equity capital, US Steel was looked to as a leader in such reports.

In the wake of the commercial expansion following World War I, the United States became a global source of capital and Wall Street arguably replaced Lombard Street as the major capital center of the world. The influx of the public or main street investors as capital providers and the exuberant formation of capital on Wall Street during the 1920s, combined with a rapidly maturing community of accounting practitioners directed largely by leaders of the CPA movement, led the discipline of financial accounting to become engaged and then married to the notion of financial reporting – continuing a reality that has been so ever since. The penchant for uniformity in accounting previously alluded to would diminish following the Great Crash of 1929 and the subsequent destabilizing “Ivar Kreuger Crash” of March 1932. The regulation of the capital markets and the introduction of the securities acts into the domain of professional accounting would have untold consequences upon the role of accounting and disclosure (Flesher and Flesher, 1986). The world of financial accounting and reporting was to evolve as a facet of the information age, wherein, as Walter Wriston (1919–2005) observed, “Information about money has become almost as valuable as money itself” (Bass, 1996). Moving into that “age” would not be simple or direct. It would be a series of disconnected episodes, perhaps only discernible to those with the time and perspective to ponder the changes of the past as a prologue.

1920 and after: principles to postulates

Early in his career, William A. Paton included a chapter in his Accounting Theory textbook on the basic postulates underlying the structure of accounting (Paton, 1922). Another author, John B.
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Canning, in *The Economics of Accountancy*, developed a conceptual framework for asset valuation and measurement based on future expectations (Canning, 1929). The works of both Paton and Canning influenced many future theoreticians (Zeff, 1999, p. 90). An early organizational attempt to develop a conceptual framework for accounting came in 1936, when the American Accounting Association (AAA) published a committee report entitled “Tentative Statement of Accounting Principles Affecting Corporate Reports.” The objective of the “Tentative Statement” was to provide the Securities and Exchange Commission (SEC) with guidance regarding what should appear in financial statements. Since the passing of the Securities Acts in the 1930s, there had been pressure for companies to provide more and better publicly available information. There was in the minds of some academic accountants a view that practitioner organizations, such as the American Institute of Accountants (now AICPA), would not want to openly address such guidance. Therefore, the AAA initiated what would become a series of attempts to develop a fuller expression of accounting principles. The objective was to make a tentative declaration of what principles should underlie financial statements without being held back by concerns about conflicting with existing practice. Three main points were contained in the first document, the last two of which were controversial: (1) transactions were to be recorded at historical cost and not at “value”; (2) the all-inclusive concept should be used in the preparation of the income statement rather than the current operating view, which excluded non-recurring and similar items from income statements; and (3) there should be a distinction between paid-in capital and retained earnings. The 1936 document was revised in 1941, 1948, and 1957. The first two revisions were based upon the historical cost principle, matching, and existing practice, and represented little change from the 1936 pronouncement. The 1957 revision, however, deviated from established practice and was not widely accepted. The 1957 version introduced the term “standards” in place of the word “principles” that had been used in 1936 and 1941 and “concepts” that had been used in 1948. The 1957 pronouncement also recommended some form of price-level adjustments – a controversial position.

**Sanders, Hatfield, and Moore: Statement of Accounting Principles**

The 1936 AAA “Tentative Statement” was followed in 1938 by a publication authored by Thomas H. Sanders, Henry Rand Hatfield, and Underhill Moore entitled *A Statement of Accounting Principles*. This too was designed to provide guidance to the new SEC. The American Institute of Certified Public Accountants and the predecessor firm of today’s Deloitte sponsored the project. It was a survey of “what was being done” in practice intended to provide authoritative guidance about existing practice, as opposed to the AAA pronouncement that had offered a more normative view, including suggestions for improved reporting. Together these documents constituted an early example of positive versus normative thought developments. To say that the 1938 volume represented a conceptual framework would be true only to the extent that current practice represented the conceptual framework.

John R. Wildman, who had been the first president of the American Accounting Association in 1916, was by then a Haskins & Sells partner and New York University professor who was closely associated with the development of *The Statement of Accounting Principles*. Arthur Foye, a future managing partner of the firm, noted that when the Haskins & Sells Foundation projected *The Statement of Accounting Principles* in July, 1935, Mr. Wildman through his knowledge of and acquaintance with distinguished educators arranged for Professor Thomas H. Sanders . . . and Professor Henry Rand Hatfield . . . to be two of the three independent authorities.

*(Previts and Taylor, 1978)*
Regarding Wildman’s role in the project, Sanders added:

The work which the Foundation has entrusted to the committee has required frequent and intimate association between Mr. Wildman and myself. Although I have for years known and admired his ability and character . . . I have been constantly surprised by his penetration, understanding and unfailing sound judgment.

(Previts and Taylor, 1978)

Studies of contemporary and acceptable accounting principles seemed to gain attention during the years of the Great Depression. Previously, accounting reports had been used by internal management and outside investors and creditors. But with the establishment of the SEC in 1934, the role of general-purpose financial statements became broader. Accountants preparing financial statements were to produce statements that achieved full and fair disclosure, a more common-law objective than the prescriptive uniformity of an earlier era. All of this was now subject to federal law. The writings of George O. May, arguably one of the most influential accountants of his age, in 1943 suggested at least ten major uses of financial statements, many of which could not be achieved by general purpose statements (May, 1943). A perceived violation of generally accepted accounting principles in such disclosures could have dire results. In addition, the federal government’s increasing role in regulation in all areas of the economy under President Franklin D. Roosevelt led to more emphasis on financial statements.

The Haskins & Sells Foundation and John Wildman recognized that need by funding the research of Sanders, Hatfield, and Moore. The Foundation urged the authors to observe accounting practice and identify a body of principles that could become useful in unifying thought and helping to standardize practice. It was stated by the Foundation:

The three authors saw their assignment as a rational identification and classification of current accounting practice rather than as a re-examination of any specific practices. Thus, the published volume represented an extensive inventory that would become an uncritical acceptance of existing accounting methods. Copies of the final report (116 pages, plus 22 pages of notes regarding legal
provisions of concern to accountants) were distributed in 1938 to all members of the American Institute of Accountants. In 1970, Foye summarized the volume in the following words:

It was clearly a broad-based and logical approach, new to the field of accountancy literature and uniquely valuable to the profession. Coupled with the merits of their research method, the acknowledged competence and impartiality of the Committee members gave to *A Statement of Accounting Principles* persuasiveness and weight never previously enjoyed by any pronouncement of comprehensive scope in the annals of accountancy. The book has been widely quoted by courts and commissions and by writers on accounting subjects generally. Without doubt judicial and other governmental authorities, as well as bankers, other business executives, and investors, derived from it a better understanding of the unwisdom of trying to oversimplify some of the inherent complexities of accounting. To many such persons the report made it clearer than before that accounting is far from being an exact science.

(Foye, 1970, p. 88)

The volume was reprinted by the American Accounting Association in 1959. This episode occurred during the first years when the identification of a body of authoritative accounting principles, known as generally accepted accounting principles (GAAP), was beginning. Thus, the Sanders, Hatfield, and Moore volume was a pioneer study activity of a positive nature attempting to inform the establishment of GAAP.

As the economy transitioned from economic emergency to the war effort, Victor H. Stempf of Touche, Niven & Co., while serving as president of the American Institute in 1944, provided his view of the growing and essential importance of accounting:

> With startling speed, particularly during the last two decades, accounting has become a potent social force in the interpretation, direction, and control of our evolving national economy. As the government has extended its control and supervision over economic activities, it has become more and more apparent that accounting is an important instrument of regulation. It has clearly demonstrated its value as a management device under a free-enterprise system. It is equally evident that it will continue to be of great importance under any system of relationship between government and business. Through one emergency after another it has manifested its ability to meet new tasks and new conditions promptly and satisfactorily.

(Stempf, August 1944, p. 102)

The theoretical background and framework of such a “potent social force” requires study to guide whatever may be proposed to regulate or oversee it.

**Paton and Littleton**

Also during this era, in 1940, the AAA published a monograph that proved to be highly influential – Paton and Littleton’s *An Introduction to Corporate Accounting Standards*. The Paton and Littleton volume was income statement oriented and presented a strong rationalization of the historical cost and matching principles that were becoming widely used. Because of the academic renown of the authors, the monograph was widely used in college classrooms, and it popularized and perpetuated historical cost as a value measure. According to Accounting Hall of Fame member Reed K. Storey, the Paton and Littleton monograph had its major impact on accounting practice because it was so widely used in classrooms and because its two signature principles found their way into nearly all textbooks. Generations of students were directly or
indirectly influenced by Paton and Littleton’s writing as a gospel for accountants. It was this gospel, Storey noted, to which the early members of the Financial Accounting Standards Board (FASB) had been exposed during the 1970s. Thus, regardless of the changing environment, especially as to capital sourcing where institutional investors supplanted individual/retail investors, the early Board members were often unwilling to vary from the historical cost principle and the concept of matching revenues and expenses (Storey, 1999).

The post–World War II era

In the late 1940s and into the 1950s, disagreements arose over several controversial issues in accounting. Inflation following World War II led some accountants to argue that current costs or price-level adjusted figures should be shown in the financial statements. Furthermore, the treatment of deferred taxes and the reporting of extraordinary and unusual items did not seem to fit with the accepted concepts of the time. The environment was changing, and the concepts of the 1930s and 1940s did not always seem applicable. In 1958, AICPA president Alvin R. Jennings sought the establishment of an entity to conduct research on basic accounting concepts, and the managing partner of Arthur Andersen & Co., Leonard Spacek, publicly criticized the profession for not establishing the premises upon which accounting standards were based. The result was the establishment of the Accounting Principles Board (APB) in 1959 to replace the previous, initial authoritative body, the Committee on Accounting Procedure (CAP). CAP had been hastily assembled in the late 1930s in an opportunistic response to the SEC’s Accounting Series Release No. 4, which recognized that efforts by such a group would constitute “substantive authoritative support” as to the basis of acceptable principles. Unfortunately, most of the CAP’s efforts over its 20-year lifespan were directed at narrow issues and were never based on a conceptual framework of any kind.

In response to Jenning’s efforts, respected professor Maurice Moonitz of the University of California at Berkeley was hired by the AICPA as Director of Accounting Research. Moonitz took it upon himself to write a research study, *The Basic Postulates of Accounting*, which was published in 1961 as the APB’s Accounting Research Study No. 1. From the contents, readers could not discern whether Moonitz was supporting historical cost or some other basis of valuation, and there was criticism that the study was too vague and unrelated to practice.

In 1962, Moonitz joined with future FASB charter member Robert T. Sprouse to conduct a follow-up study that was published as APB Accounting Research Study No. 3 under the title *A Tentative Set of Broad Accounting Principles for Business Enterprises*. Based on Moonitz’s earlier postulates, Moonitz and Sprouse argued for greater use of current values in accounting and less reliance on the realization concept. The use of discounted present values for receivables and payables was also advocated, which was a little-known concept in 1962. Accounting Research Study No. 3 was thought to be too radical, and the work was not well received in the practice community.

Moonitz and Sprouse had thought their assignment was to develop a rational argument for a sound approach to financial reporting. Most members of the APB and other leaders of the accounting profession, by contrast, looked upon basic research as an instrument for rationalizing the status quo (in the tradition of the Paton and Littleton monograph), rather than as a normative argument for fundamental change in accounting. Above all, the SEC was at that time a conservative regulator, which regarded departures from the “objectivity” of historical cost accounting as possessing the potential to deceive the readers of financial
statements. In the 1960s, the SEC saw its mission chiefly as one of guarding against misleading financial statements rather than of improving the information content of the statements. As a result of the APB’s rejection of the postulates and principles studies, the cause of basic accounting research as a foundation stone for pronouncements on specific subjects suffered a severe setback, and the board instead began to deal with specific issues, much as had the CAP before it, without a body of underlying concepts on which to draw. (Zeff, 1999, pp. 94–95)

The APB issued two additional publications relating to accounting concepts. In 1965, Accounting Research Study No. 5, by retired Price Waterhouse partner Paul Grady, was issued under the title Inventory of Generally Accepted Accounting Principles for Business Enterprises. As in the case of the 1938 Sanders, Hatfield, and Moore monograph, Grady felt that theoretical explanations should be derived inductively from observing existing practice (Zeff, 1999, p. 95). Grady did show how concepts were included in current practice, but his study offered little that sought to improve practice. Accounting Research Study No. 5 was, however, a popular resource in other countries where individuals were seeking a catalogue of then current US practices; it sold briskly for many years after its publication.

In 1964 and 1965, the APB was under attack because of the debacle that arose over its issuance of Opinions No. 2 and No. 4 on the investment tax credit. The AICPA Council formed a special committee chaired by J. S. Seidman to (1) review the status of APB opinions and (2) assess the development of accounting standards. In May 1965, the Seidman Committee reported on its second charge with the recommendation that there should be an authoritative identification of generally accepted accounting principles and that the APB should

1. Set forth the purposes and limitations of published financial statements;
2. Enumerate and describe the basic concepts that accounting principles should follow; and
3. Define the key terms used in the profession.

In 1970, in response to the Seidman Committee, the APB issued Statement No. 4, entitled Basic Concepts and Accounting Principles Underlying Financial Statements of Business Enterprises. Statement No. 4 was not an authoritatively required document and was often described as a disappointment since it provided little guidance for the future development of accounting principles. Reed Storey stated that the APB “gave every indication of having issued it primarily to comply, somewhat grudgingly, with the Seidman Committee’s recommendations” (Storey, 1999, pp. 2-28).

As global influences began to make themselves felt in the post–World War II era, one particular group of scholars, headed up by Foundation Chair Professor of Accounting Ray Chambers at the University of Sydney (an indelible influence on the reputation of what has come to be called the Sydney School of Accounting), made itself known. By the early 1970s, Chambers was a regular visitor at leading American universities, lecturing about the intrinsic superiority of what he had identified as “continuously contemporaneous accounting,” also called COCOA or exit-price value measurement. Chambers debated and argued effectively in the domain of historical cost and matching communities, and long before it became better known due to the efforts of others in the late twentieth and early twenty-first centuries, Chambers remained an ardent supporter of COCOA. His success, however, was limited to being recognized as a superior theorist while few converts were found in practice. Nevertheless, the stage was set for more debate, and his influence continues to be recognized and felt despite his retirement in 1982 and his death in 1999 (Clarke et al., 2012). Indeed, the influence of Chambers and his association
with Robert Sterling and Stephen Zeff culminated in many important intellectual activities and papers, particularly during the period of debates involving the appropriate accounting for the difficult inflationary period of the 1980s in the United States.

**ASOBAT and SATTA**

In 1966, a committee of the AAA chaired by Charles T. Zlatkovich published a monograph entitled *A Statement of Basic Accounting Theory (ASOBAT)*. *ASOBAT* was based on supporting the objective of decision usefulness, which had been identified and promoted in an *Accounting Review* paper by H. Justin Davidson and Robert Trueblood in 1961 (p. 582). Their thesis promoted the integration of stewardship and decision making. *ASOBAT* defined accounting as “the process of identifying, measuring, and communicating economic information to permit informed judgments and decisions by users of the information” (AAA, 1966, p. 1). In other words, the emphasis was not on stewardship but on information that would benefit decision making regarding the future by users of financial statements. Besides the emphasis on decision usefulness, *ASOBAT* also argued in favor of a dual reporting system wherein both historical costs and current values would be reported. Stephen Zeff later called *ASOBAT* “one of the most important studies ever issued by the Association, both in terms of impact on the literature and on standard setting” (Zeff, 1991). *ASOBAT* was widely distributed; all members of the AAA received a free copy, and an additional 9,000 copies were printed to be sold to non-member practitioners. If Zeff’s evaluation is correct, it is telling because the emphasis on decision making would have significant conceptual design implications for the future of accounting and the search for guidance and the development of frameworks.

Decision making is, after all, an idiosyncratic function, one that, like leadership, is unique to individuals and tempered by their values and experiences; decision making falls under the classic “black-box” term, *judgment*. Further, in the American business system, pragmatism, not merely of a make-a-buck nature but of a more deeply philosophical nature, as captured in the writings of John Dewey and others associated with the academy, would now require consideration. It would be more than a decade before another academic committee would attempt to sort through the philosophical implications of such an “integration” of stewardship and decision making. Richard Mattessich once pointed out the role of the scientific method to one of the authors of this essay as to resolving such intellectual challenges. He noted the writings of P. W. Bridgman, the 1946 Nobel Laureate in Physics, who had taken part in the project that resulted in the discovery of atomic energy and the weapon it created. Bridgman noted: “The scientific method, as far as it is a method, is nothing more than doing one’s damnedest with one’s mind, no holds barred” (1945). Bridgman’s admonition suggests a form of American pragmatism that is not in conformity with a rigid structure of research observing merely logical consistency or similar forms of positive or normative influences.

However, adherence to the norms of logic and science seems evident in the 1977 AAA Statement on Accounting Theory and Theory Acceptance (SATTA). The committee’s charge, developed in 1973, was to prepare a statement that would provide the same type of survey of current thinking on accounting theory as *ASOBAT* had done in 1966. However, the committee was unable to align the various schools of thought identified in the literature. It never directly addressed the philosophical aspects of accounting theory, including the implications of pragmatic decision making and accounting judgments. *SATTA* was, however, a useful summary and digest of the major legacy views of positive and negative epistemologies and of the recently developed information economics. However, the committee could not achieve the consensus needed to address theoretical problems facing accounting, leading to a view that under these
circumstances a disparate appointed committee was ill suited to conduct research (AAA, 1977, p. 49). Hakansson summarized the contributions of SATTA as follows:

It does bring a number of seemingly disparate threads together in a way which is, on balance, helpful. It reflects faithfully the recent broadening of the accounting horizon and the gradual lifting of scholarly standards that is currently in motion. It suggests, if only indirectly, that careful attention to less ambitious slices of the accounting problem is essential to further progress.

(Hakansson, 1978, p. 724)

The Trueblood Committee

The AICPA’s Study Group on the Objectives of Financial Statements, better known as the Trueblood Committee, issued its report in October 1973. The Trueblood Committee was formed by the AICPA in 1971 at the same time that the Wheat Committee was established to consider the institutional process by which authoritative pronouncements were to be undertaken in the wake of the demise of confidence in the Accounting Principles Board and the Supreme Court decision in the Continental Vending case. The Trueblood Committee was composed of practitioners, academics, and users of financial statements. The chairman, Robert Trueblood, was a practitioner and professional leader who had coauthored the 1961 *Accounting Review* article on “decision usefulness.” The charge to the committee was to determine the objectives of financial statements. George H. Sorter, a professor at the University of Chicago, was appointed the research director of the Trueblood Committee. Sorter had been a member of the AAA ASOBAT Committee. Both Trueblood and Sorter were influential in orienting the committee toward the decision-usefulness concept. The origin of the decision-usefulness concept, which now has been adopted as a central objective, is attributed to former FASB director of research George Staubus, who developed the concept in his 1954 University of Chicago dissertation and in later articles in *The Accounting Review*. Sorter had also studied at the University of Chicago and while there had read Staubus’ work (Staubus, 2003, pp. 165–166). Sorter had also reviewed Staubus’ 1961 book on the subject (*A Theory of Accounting to Investors* [Staubus, 1961; Sorter, 1963]). Because of these prior exposures, the articulate Sorter was able to convince both the ASOBAT Committee and the Trueblood Committee of the importance of emphasizing the needs of the growing community of what today is known as institutional investors. The Trueblood report, entitled *Objectives of Financial Statements*, focused on future cash flows. Yet a key audience for financial statements was also viewed as “those users who have limited authority, ability, or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise’s economic activities” (*Objectives . . . , 1973, p. 17*). The basic emphasis was on investors and creditors, but employees were also included in the definition of users.

As with ASOBAT, the Trueblood report enumerated qualitative characteristics of financial reporting and concluded that a single valuation basis was not sufficient in the preparation of effective financial statements; mixed attributes were necessary. Several valuation bases were recommended and examples given of when each basis would be relevant. There was also a suggestion that measurements in terms of single numbers that do not include ranges do not effectively describe events that are subject to uncertainty. Ranges of precision and reliability should be included in the financial statements. The Trueblood report also advocated a form of social reporting (*Objectives . . . , 1973, pp. 54–55*). The Trueblood report was forward thinking,
identified departures from past accounting practice, and would serve as a model for future FASB activities. It was based to some extent on previous conceptual studies by the AAA and APB, but it was not tied to any of the predecessor pronouncements entirely. Zeff summarized the Trueblood Committee's work as follows:

The Trueblood report was remarkable for the freshness of its approach. It did much to refocus discussions in the accounting policy arena from stewardship reporting to providing information useful for decision makers. The report became a kind of blueprint for the conceptual framework project that the newly established FASB was just beginning.

(Zeff, 1999, p. 101)

Unfortunately, there was one paragraph near the end of the Trueblood report that, while connecting with the future FASB Concepts Statements, was not a positive attribute:

Members of the Study Group disagree on whether value changes . . . should be included in earnings. Some believe the objective should be to reflect current value changes in earnings. Others believe that inclusion of unrealized value changes in earnings may be desirable but is not now practicable. Still others believe that their inclusion is neither desirable nor practicable.

(Objectives . . . , 1973, p. 64)

The above paragraph would foretell much of the debate that the FASB would undertake in the ensuing decades.

The FASB conceptual framework

When the FASB began operations in 1973, the Board considered twenty-seven initial agenda items, but it quickly decided to pursue only seven. Of those seven, two could be considered elements of what later came to be called the conceptual framework project.2 One of these two projects was initially called “broad qualitative standards for financial reporting” and the other was “materiality.” Nothing ever came of the materiality project, but there were ten paragraphs on the subject in the second Concepts Statement issued in 1980. It was the “broad qualitative standards” project that subsequently, in late 1973, came to be known as the conceptual framework project. The purpose of the project was to set forth fundamentals upon which financial accounting and reporting standards were to be based. According to the introduction to the first statement, the “Concepts are intended to establish the objectives and concepts that the Financial Accounting Standards Board will use in developing standards of financial accounting and reporting” (SFAC No. 1, FASB, 1978, p. i). The introduction went on to say that the Board itself was likely to be the major user and most direct beneficiary of the guidance provided in the series of publications. Nevertheless, all individuals affected by financial accounting standards were foreseen to benefit to some extent from the conceptual framework. It was also noted that Concepts Statements were not GAAP, and therefore accountants did not have to comply with the ideas expressed in the Concepts Statements. When something in a Concepts Statement was inconsistent with current standards, accountants were not to deviate from the standards currently in place (SFAC No. 1, FASB, 1978, p. ii).

The objectives of the conceptual framework project did not include resolving accounting issues but were intended to set the stage for solving such problems in the future. Marshall Armstrong, the FASB’s first chairman, stated in 1976:
The conceptual framework project will lead to definitive pronouncements on which the Board intends to rely in establishing financial accounting and reporting standards. Though the framework cannot and should not be made so detailed as to provide automatically an accounting answer to a set of financial facts, it will determine bounds for judgment.

Reed Storey, an FASB staff member who became extensively engaged in the project, later wrote:

The Board undertook the self-imposed task of providing accounting with an underlying philosophy because Board members had concluded that to discharge their standards-setting responsibilities properly they needed a set of fundamental accounting concepts for their own guidance in resolving issues brought before the Board.

(Storey, 1999, pp. 1–47)

Has this happened? One study conducted after the issuance of the sixth Concepts Statement found that of several standards approved after the completion of the project, none were entirely consistent with the framework. This disconnect was attributed to the fact that the conceptual framework did not take into account the social and political environment in which standards are promulgated (Gore, 1992).

In many people’s minds, a conceptual framework for accounting was needed, if for no other reason than that accountants had never agreed on the objectives of financial reporting. As attractive as a conceptual framework sounds in theory, there are critics who charge that the FASB framework is not useful. For example, writing in 1987, Dale Gerboth, then a partner with Arthur Young & Company and a former AICPA and FASB staff member, concluded:

For better or for worse, the accounting profession seems irrevocably committed to undergirding its standards with the strongest – or at least the most expensive – methodological foundation that money can buy. Yet, as the dust settles around what seems to be the completed conceptual framework, there is an unmistakable sense of disappointment with what the profession got for its money. Lee Seidler spoke for many when he dismissed the draft of what later became FASB Concepts Statement No. 5 as “doing nothing but consuming paper and words.” Not a few among Seidler’s fellow accountants would apply that description to the conceptual framework as a whole.

(Gerboth, 1987, p. 1)

Actually, Seidler blamed the problems on the fact that there were no conceptual frameworks in the social sciences and felt that the FASB was ignorant to think that one could be developed.

Despite the objections to a conceptual framework, the majority of accountants were initially supportive of such an undertaking by the FASB (as they had been in earlier years with earlier standard-setting bodies). Given that the conceptual framework project was implemented for the benefit of the Board itself, it might not be relevant that outsiders have been critical; only the Board members themselves are in a position to know whether the framework has accomplished the purposes that were set out for it. The views of Donald Kirk, a former FASB chairman and partner at PWC, were perhaps typical of other Board members; he stated after leaving the Board:

I accepted the conceptual framework project in the early years on faith. It was faith in the belief that something needed to be done beyond just the structural changes that had resulted in the independent, full-time FASB. If the development of objectives of financial statements, definitions of the elements thereof, and other concepts would help show the way by logical deduction to sound and consistent standards, I was all for it.

(Kirk, 1988, p. 12)
Over time, the conceptual framework also has raised issues regarding pedagogical coverage and consistency. Intermediate accounting textbooks typically include a chapter or major section on concepts. However, one early study on how widespread the teaching of the framework was concluded that coverage in intermediate accounting classes was superficial and that Concepts Statements No. 1 and No. 2 were covered more often than were the later statements. Apparently, time limitations are one of the reasons that the concepts are not always taught; those instructors who had more class hours available for intermediate accounting (in excess of six semester hours for the subject) were more apt to teach the concepts (Smith, 1986).

The conceptual framework has been widely noticed by other standard-setting organizations throughout the world. Because of the efforts of the FASB, standard-setting bodies in other countries, including the International Accounting Standards Committee, implemented similar projects. In some cases, the FASB framework was adopted with little modification (Beresford, 1998, p. 159). However, one could question whether this was a good thing, given that the cultural complications of the conceptual framework in the United States was likely to differ from the political and economic environment and traditions in other nations.

The efforts to establish the conceptual framework has had an impact on the FASB. In the early years, acceptance of the need for a framework made for slower progress on standards until some consensus was reached; later it was slowed by the time that the Board was forced to devote to the framework project. The amount of Board and staff time spent on the Concepts Statements was considerable. Van Riper estimated that in the early 1980s the technical staff spent 40 percent of its time on the conceptual framework (1994, p. 81). As Britain’s Edward Stamp pointed out in a 1983 interview, “The U.S. Supreme Court doesn’t realize how lucky it is that it was given a Constitution by the founding fathers instead of having to frame one of its own” (Stamp, 1984, p. S3). The efforts of the SATTA developers and the Trueblood Committee were considerable, but the result was not a [fully formed] conceptual framework of accounting.

**The FASB Concepts Statements**

Through the end of 2012, the FASB has issued eight Concepts Statements. Together, these statements comprise the conceptual framework of financial accounting. One of these, No. 4, deals with not-for-profit entities; the remainder are considered below. The FASB issued its first publication associated with the conceptual framework project in mid-1974 in the form of a Discussion Memorandum. However, that memorandum was little more than a reprint of the 1973 report of the Trueblood Study Group (Van Riper, 1994, p. 20). The first formal Concepts Statement was published in 1978, followed by five others through the end of 1985. The seventh statement was issued in February 2000 and the eighth in September 2010.

**Concepts Statement No. 1: Objectives of Financial Reporting**

Five years after it was founded, the FASB finally decided upon the objectives of financial reporting. The first Statement of Financial Accounting Concepts (SFAC), entitled *Objectives of Financial Reporting by Business Enterprises*, was issued in November 1978. The pronouncement had been preceded by a Discussion Memorandum in June 1974 and a public hearing in September 1974. It was over two years later, in December 1976, that the Board issued an analysis of the public hearing under the title *Tentative Conclusions on Objectives of Financial Statements of Business Enterprises*. Another public hearing followed in June 1977.

SFAC No. 1 included the following two basic elements, which had also appeared in the Trueblood Report:
Financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions. The information should be comprehensible to those who have a reasonable understanding of business and economic activities and are willing to study the information with reasonable diligence.

Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans.

Thus, the target audience is present and potential investors and creditors, who have a reasonable understanding of business; the information presented should help that audience assess future cash flows from their investments. The specific identity of an investor, however, was likely to be itself a matter of later dispute, as the idea of “user needs” prevailed in determining the content of disclosures. Publicly available equity capital sourcing information for recent years suggests that direct investment funds from individual/retail investors are declining rapidly. To some, this could signal a shift in “user needs.” Since investors’ and creditors’ cash flows are related to enterprise cash flows, financial reporting should provide information to help investors, creditors, and others assess the amounts, timing, and uncertainty of prospective net cash inflows to the enterprise. Also, SFAC No. 1 stated that financial reporting should provide information about the economic resources of an enterprise, the claims to those resources, and the effects of transactions, events, and circumstances on the resources and claims to those resources. “Investors” and “creditors” were terms that were used broadly and included not only those who have or contemplate having a claim to enterprise resources, but also those who advise or represent them. Although investment and credit decisions reflect expectations about future enterprise performance, those expectations are commonly based at least partly on evaluations of past enterprise performance. The primary focus of financial reporting is information about earnings and its components. Information about enterprise earnings based on accrual accounting generally provides a better indication of an enterprise’s present and continuing ability to generate favorable cash flows than information limited to the financial effects of cash receipts and payments. Unlike the Trueblood Report, SFAC No. 1 did not address the wider role of financial reporting, including such elements as social reporting. Broader social issues as a whole, beyond entity economic operations, were not seen by the Board as meeting the definition of a need for users of financial statements.

As straightforward as the first statement’s contents seem to have been, there was not universal agreement on those objectives among the Board’s constituency, which explains in part why SFAC No. 1 was slow to come to fruition. According to Chairman Marshall Armstrong, there was little agreement among surveyed constituents on the provision that “the basic objective of financial statements is to provide information useful for making economic decisions.” This was taken word for word from the Trueblood Report, but less than 40 percent of surveyed respondents were in agreement. For those who objected, the primary view was that the basic function of financial statements was to report on management’s stewardship of corporate assets and the information needs of investors were secondary (Armstrong, 1977, p. 77). Many of those who objected were managers, while the supporters were investors or their representatives. Auditors, too, would have been opposed to a wider audience for financial statements, since that might be accompanied by greater exposure to the risk of litigation without any corresponding benefits to the audit firm (Dopuch and Sunder, 1980). Overall, about 10 percent of the comment letters were from academics, just under 10 percent from public accountants, about 20 percent
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from banks and other financial institutions, and the remainder from industry preparers. Many accountants were strongly aligned with the importance of the stewardship function, which was fundamental to what they had learned in college, and were not ready to accept a decision-usefulness objective for accounting, especially if it was seen as being superior to stewardship and meant shifting away from the matching concept and the message of the income statement.

The opposition to the decision-usefulness concept was well organized under the leadership of Robert K. Mautz of Ernst & Ernst. Mautz was on the FASB’s Conceptual Framework Task Force and had access to all materials being developed. He and his firm were fully supported by the Financial Executives Institute. The reason for opposition was the fear that the acceptance of decision usefulness as an objective would lead to the adoption of current value accounting and a balance sheet focus to reporting. If that happened, management could lose its discretion over earnings, the management of which was of importance to their own performance evaluations. Managers might be less able to select from choices about historical cost values and convert them into realized gains or losses as the need arose. Managers, critics charged, did not care about the needs of investors; they were most concerned with reporting that would reflect positively on their own careers. Mautz and his firm’s position coincided with that of the management teams of their clients (Staubus, 2003, p. 184). Their opposition slowed the process, but gradually a decision-usefulness orientation prevailed. Recently, in a letter to former FASB chairman Donald Kirk, George Staubus opined that “I still think that that period when it stood up to fierce resistance from Bob Mautz, Ernst & Ernst, and the FEI was the Board’s finest hour” (Staubus, November 15, 2009). Given the consolidation of capital providers that occurred in the wake of the Financial Modernization Act of 1999, wherein investment banks, commercial banks, insurance companies, mutual funds, and other capital sources were able to combine into single powerful capital provider entities, and when liquidity would once again become a focus, the decision usefulness that would prevail would be dictated by the “golden rule” of capital markets, namely, “Those who have the gold (i.e., capital) set the rules.” Oversight of the FASB would evolve toward representation by institutional investors and bankers as the Financial Accounting Foundation became increasingly represented not by auditors or preparers but by capital providers. But this was an episode yet to come, many years in the future. What SFAC No. 1 was to represent in that coming period would be a shift from the primacy of the income statement and the process of matching to a twenty-first-century focus on the balance sheet once again as the principal financial statement, with income being measured not in Patonian matching terms but in Hicksian terms, namely determining how much “better off” a business would be between the beginning and the end of the measurement period in value terms.

Don Kirk’s views regarding the delays in issuing SFAC No. 1 related that an objection to an emphasis on the decision needs of investors and other external users was also seen as a defense against current value accounting and in support of historical cost and matching. Kirk went on to conclude:

With hindsight, most observers will think the Objectives Concepts Statement says the obvious, but at the time it was not widely accepted to acknowledge the preeminence of external users in the determination of accounting standards. Some of the opposition was blunted when the Board accepted the suggestion that it focus on the objectives of financial reporting, not just financial statements. It was thought by this broadening that, as under the securities laws, the needs of users could be satisfied through disclosures, possibly even separate from the financial statements, and, therefore, not require the type of income measurement changes that opponents feared.

(Kirk, 1988, p. 13)
SFAC No. 1 did make official what audience the Board, and preparers of financial statements, was addressing – namely external users. According to most sources, the objectives in SFAC No. 1 have been highly influential in the setting of accounting standards. A necessary and fundamental criticism was the amount of time it took for SFAC No. 1 to come to fruition and the costs involved, given that the FASB had the benefit of the work previously done by the Trueblood Committee. According to Reed Storey:

It may be unfortunate that it took five years and substantial cash for FASB to get the objectives accepted, but that’s the way the real world works. *Changing peoples’ minds takes time* [emphasis added]. When you consider that acceptance of the objectives involved reversing long-held attitudes, five years is not so long. Rather than a basis for criticism, those five years practically produced a miracle.

*(1981)*

Even the Business Roundtable, a group that was pervasively critical of the FASB, had few criticisms of SFAC No. 1. In a background paper prepared by staff at General Motors, the members of the Business Roundtable were told that “Statement #1 is so broadly written that little quarrel can be taken with its general comments and conclusions” (Smith, March 29, 1982). However, later in the same year, members of a Business Roundtable task force seemingly did object to some of the objectives in SFAC No. 1.

Today, many years after its adoption, parts of SFAC No. 1 remain the subject of debate. In fact, it was superseded by SFAC No. 8 in September 2010. Former Board member David Mosso, who served on the Board when the first six Concepts Statements were approved, recently made the following statement with respect to the contents of SFAC No. 1:

Those are good objectives, but they are too broad to give sharp focus to an accounting system suitable for twenty-first century economies. At the time they were adopted, those broad objectives were ground breaking and forward looking. They turned the GAAP model away from the then prevalent stewardship notion of accounting and re-oriented it toward economic decision making. The objectives paved the way for many subsequent improvements in GAAP. But they were not strong enough to be translated into a coherent accounting model with consistent recognition criteria and a single measurement method – they left us with vague recognition criteria and multiple measurement methods, in short, a choice-based model.

*(Mosso, 2009b)*

Mosso’s intent when stating the above was to point out that the Concepts Statements do not support fair value accounting, which he observes to be a weakness of all of the Concepts Statements.

**Concepts Statement No. 2: Qualitative Characteristics**

In May 1980, a year and a half after the issuance of the first Concepts Statement, the FASB issued Concepts Statement No. 2, entitled *Qualitative Characteristics of Accounting Information*. Much of the work of developing SFAC No. 2 was contributed by David Solomons, an accounting professor at the University of Pennsylvania. Solomons believed strongly that neutrality was central to the effectiveness of the standard-setting process. Decision usefulness was also accepted as a major goal of SFAC No. 2, with emphasis on the qualitative elements of relevance, reliability, and comparability.
SFAC No. 2 was perhaps the least controversial of the Concepts Statements because, according to past Board Chairman Donald Kirk, “readers did not see implications that portended current value accounting” (1988, p. 13). Also, the clarity of SFAC No. 2, largely attributed to Solomons, made it less controversial. The criticisms that did arise included the fact that the idea of decision usefulness was so vaguely stated as to be of little practical use (Sweeney and Yaari, 1998, p. 42). David Mosso, who was, as noted above, involved with the first six Concepts Statements, did not object to SFAC No. 2, but neither did he applaud it. He stated that he was supportive because he thought that it brought a “good bit of order to the GAAP accounting model. It was the best we could do at the time and I am a believer in moving forward as long as there is a net gain” (Mosso, 2009c). He explained his current views as follows:

The framework implicitly endorsed alternative methods by devoting one whole concepts statement, CON 2, to so-called qualitative characteristics: “... the qualities to be sought when accounting choices are made.” Unfortunately, the ten or so qualitative characteristics described in CON 2 are truisms. They are essential qualities of any good measurement system but they are consequences not causes. My butchers’ scale has all of the CON 2 characteristics, the current accounting model has none. The difference is that the butchers’ scale has a clear objective, a design to achieve it, and an inspection process to maintain its integrity. The accounting model does not. The moral is: Establish a clear measurement objective and the characteristics will follow naturally.

(Mosso, 2009a, p. 34)

One of the elements addressed in SFAC No. 2 was the importance of standard setters weighing the relative costs versus benefits of adopting new standards. The cost/benefit ratio had been a hotly debated aspect of SFAS No. 33 on inflation accounting, and that discussion carried over to the discussions about the conceptual framework. The notion of a demonstrated cost benefit of a new standard continues to be raised in present-day regulatory settings, most recently with the Public Company Accounting Oversight Board’s standards for auditing and in the contents of recent legislation (i.e., the JOBS Act of 2012).

Concepts Statement No. 3: Elements of Financial Statements

In December 1980, the FASB issued SFAC No. 3: Elements of Financial Statements of Business Enterprises. The contents of SFAC No. 3 were among the earliest addressed by the Board, dating back to the discussions of assets, for purposes of issuing SFAS No. 2 (research and development costs), and liabilities, at the time of the issuance of SFAS No. 5 (on contingencies). Two exposure drafts were issued before SFAC No. 3 was approved. The main criticism of the first exposure draft was the emphasis on a balance sheet approach, as opposed to the then preferred income statement, or matching, approach. In a 1978 comment letter to the Board from Thomas A. Murphy of General Motors Corporation, himself an accounting graduate of the University of Illinois, it was noted that the anti-matching bias was apparent throughout the draft but was summed up in paragraph 66, where the comment was made:

In other words, there is no place in articulated financial statements for items that do not fit the definitions in this statement but are sometimes said to be “required to match costs and revenues properly to measure periodic earnings” or “required to avoid distorting periodic earnings.”

(Murphy, April 19, 1978)
Murphy went on to articulate the orthodoxy, or credo, held by many accountants of the time:

> We believe that in view of the long history of the use of the matching concept, the historical emphasis on the income statement in the financial field, the use of the balance sheet as a statement of costs not values in this same field, and the overwhelming support for the matching concept expressed in the written and oral responses the Board received to the DM [Discussion Memorandum] covering the conceptual framework project, that the Board should withhold the establishment of a new balance sheet oriented concept until the entire conceptual framework study has been completed.

*(Murphy, April 19, 1978)*

Because of this and other similar letters, the Board did delay issuance of a final statement until after a second exposure draft had been issued and discussed. Despite all of the support for the matching principle, the Board countered that position, suggesting that the responses of the letter writers did not completely reflect the outcomes that matching sought or permitted.

Many of the responses indeed were vague, and it soon became clear that proper matching and distortion of periodic net income were largely in the eye of the beholder. Respondents said eventually that although they had difficulty in describing proper matching and distorted income, they knew them when they saw them and could use professional judgment to assure themselves that periodic net income was determined without distortion in individual cases. The thinking and practice described in the comment letters and at the hearings seemed to make income measurement primarily a matter of individual judgment and provided no basis for comparability between financial statements. To Board members, the arguments for including in balance sheets items that could not possibly qualify as assets or liabilities – what-you-may-call-its – sounded a lot like excuses to justify smoothing reported income, thereby decreasing its volatility. The experience generally strengthened Board members’ commitment to a broad conceptual framework – one beginning with objectives of financial statements and qualitative characteristics (the Trueblood Report) and also defining the elements of financial statements and including concepts of recognition, measurement, and display – and affected the kind of concepts it would comprise.

*(Storey, 1999, pp. 2–38)*

Although Concepts Statements No. 3 and No. 6 did not explicitly endorse the asset-and-liability view nor castigate the income statement view, it was clear by the definitions given which view the Board was adopting (Storey, 1999, pp. 1–85). Assets and liabilities are defined “as the most fundamental elements.” The Board had become convinced that definitions of assets and liabilities that depended on definitions of revenues and expenses produced by an orientation to the income statement and matching simply would not achieve an optimal decision-useful financial reporting outcome. The Board had actually come to this conclusion much earlier when it promulgated Statements No. 2 and No. 5 on research and development and contingent liabilities. Thus, the conceptual definitions of assets and liabilities had their roots in the Board’s earliest pronouncements.

Supporters of the matching principle were not the only critics of SFAC No. 3. The Business Roundtable, a group typically critical of FASB actions in the 1980s, noted that SFAC No. 3 contained some “troublesome areas, notably the introduction of the concept of ‘comprehensive income’” (Smith, March 29, 1982). The Roundtable members were informed that although the definition of comprehensive income was vague, it seemed that it would consist of the changes
in stockholders’ equity that went beyond net income as then known. Thus, they observed, “It appears that the concept was introduced to permit current value measurement of assets to be introduced without disturbing the traditional net income concept.” The group perceived that historical-cost-based financial statements would thus be replaced by fair value reporting.

**Concepts Statement No. 5: Recognition and Measurement**

SFAC No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises* (December, 1984) has been criticized for being nothing new. As Donald Kirk pointed out, “Development of the first three Concepts Statements was time consuming, and at times controversial, but nothing compared to what preceded the issuance of FASB Concepts Statement No. 5” (1988, p. 15). In July 1981, a noted academician, Robert R. Sterling, was recruited as a senior fellow at the FASB to lead the campaign to develop the statement on recognition and measurement. After two years, Sterling gave up in disgust and returned to his professorship at Rice University. Sterling later stated that “No. 5 was not a Concepts Statement” (2009). He claims the failure of SFAC No. 5 was attributable to the cleavage between historical cost and the use of fair values. Three Board members, Block, Morgan, and March, were firmly opposed to the use of fair values – under any circumstance; they would not even agree that the then current uses of fair values, such as the lower of cost or market, were acceptable. Sterling gave the example of a farmer’s corn inventory, which traditionally was valued at fair market value; corn was a fungible product with a ready market and could be sold at any time. Therefore, accountants have always valued such inventories at fair market values, but the three Board members would not agree that this treatment was acceptable and thus would not allow such mention in the Concepts Statement (Sterling, 2009). The antipathy toward anything other than valuation at historical costs was too strong for progress to be made. In fact, Kirk was so sure that nothing meaningful would come from the completion of SFAC No. 5 that he admitted in 1983 that he was ready to set the project aside. “My views at that time were colored . . . by the frustrations of trying to find common ground among a group of very different thinking Board members” (Kirk, 1988, p. 16).

Sterling came aboard at a restive time. The earlier phases of the conceptual framework had focused on the more basic aspects of accounting. Those Statements had been passed unanimously, a condition that the Board had set as a goal for itself in approving the Concepts Statements (Johnson, 1997, p. xlii). While the third Concepts Statement was delayed because of the noted objections and the need to issue a second exposure draft, it was nevertheless unanimously approved. Some Board members, however, were becoming concerned that future concepts were being put in place so as to move away from the old historical cost/matching approach toward value accounting. Although Board members may not have known initially what Sterling’s views on fair values were,³ he had long been a noted accounting conceptualist and had even presented a paper at the FASB’s June 1980 Conceptual Framework Symposium in New York. Chairman Kirk and Michael Alexander, the FASB’s Director of Research and Technical Activities, were impressed with Sterling and created a position for him, with his assignment being to work on the conceptual framework project. Sterling could not refuse the opportunity to help shape accounting’s conceptual framework and the subsequent standards that would be based on the framework.

The Board had commissioned two research reports designed to contribute to the Discussion Memorandum on recognition criteria (measurement was to have been addressed in a later phase of the project because of the Board’s concern that the issue would be more contentious). In December 1980, Yuji Ijiri’s study, *Recognition of Contractual Rights and Obligations*, was published. A month later, Henry Jaenicke published *Survey of Present Practices in Recognizing*
Revenues, Expenses, Gains, and Losses. Upon his arrival in July 1981, Sterling convinced the Board that recognition could not be effectively addressed without also addressing the issue of measurement. Thus, the project was expanded to include measurement. Sterling's definition of measurement criteria was simple – use fair values in the form of current exit values (Sterling, 1981; Johnson, 1997, p. xlv). Three members of the Board would not accept a proposal that would supplant the historical cost principle, and one or two others who were in favor of fair value were not enthusiastic about the use of exit prices. With Sterling and other staff members working toward a fair value approach, the three opposing Board members pressed to hire a researcher who would support the historical cost approach. That person was the noted academic Robert K. Mautz, who was by then working for Ernst & Whinney as a consultative partner. There was such an impasse among Board members that the fair value concept simply could not be adopted. Sterling left the FASB in June 1983, and SFAC No. 5 was eventually approved in December 1984. The final document was little more than a recap of the concepts that had been approved in earlier statements. As later noted by another FASB staff member, H. Todd Johnson, “It is not a document with which Bob would have wanted to be associated” (1997, p. xlv).

Sterling, it would seem, must have gone into the project without a full awareness of the concerns. As early as the summer of 1980, before he was ever invited to join the FASB, he observed the following:

As the framework gets nearer completion the likely changes will be more easily anticipated, and therefore it will be easier to anticipate real or imagined adversely affected vested interests. Thus, progress toward completion will be accompanied by a crescendo of perceived adversely affected vested interests, which in turn will be accompanied by a crescendo of resistance and criticism. The resistance may become so great that the board will find it impossible to complete the framework. If so, it may be forced to return to the procedure of putting out brush fires and abandon the project. I am not forecasting that outcome, but I do think that it is a possibility that shouldn’t be lightly dismissed. In short, in looking at the history I see the glass to be half full in that the board has made much more progress than its predecessors, but in forecasting the future I see the glass to be half empty in that each step in filling it is going to be increasingly difficult.

(Sterling, 1982, p. 105)

One of the reasons that some Board members were not enthusiastic about the acceptance of fair values in SFAC No. 5 was the experience that was then being noted with regard to the requirements of SFAS No. 33 on inflation accounting. While considering SFAC No. 5, the Board learned that the current cost information required under the inflation standard was not being widely used and that there were serious questions about the reliability of the information. According to Kirk, “I could find little reason to endorse on a conceptual level a current value or current cost measurement system for future standards when it appeared that the utility of such a system in Statement 33 was going to be seriously challenged” (1988, p. 16). Eventually, SFAS No. 33 was rescinded because its requirements failed to meet the cost/benefit test, primarily because studies showed that users saw little benefit, especially after inflation rates became lower and of less concern.

Eventually, through compromise, SFAC No. 5 was approved by a 6–1 vote in December 1984. The reasons for the dissent included the facts that (a) the statement did not adopt measurement concepts oriented toward what was the most useful attribute for recognition purposes,
namely the cash equivalent of recognized transactions reduced by subsequent impairments or loss of service value – instead the statement suggested selecting from several different attributes (i.e., a mixed-attribute approach) without providing sufficient guidance for the selection process; (b) it used a concept of income that was based on measurements of assets and liabilities and changes in them, rather than adopting the concept of earnings as the definition of income (i.e., it recommended the publication of a statement of comprehensive income); and (c) it failed to provide sufficient guidance for initial recognition and derecognition of assets and liabilities. Finally, the dissent noted the following:

Disregarding the foregoing objections, Mr. March believes this Statement offers insufficient guidance for the near-term future work of the Board. To be useful, it needs to be supplemented with more specific guidance for selecting measurement attributes for specific assets, liabilities, and transactions and for deciding when the criteria require recognition or derecognition of an asset or a liability.

(SFAC No. 5, 1984, para. 91)

March’s dissent was the only dissent on any of the first six Concepts Statements.

David Mosso, a member of the FASB who voted in favor of SFAC No. 5, apparently had second thoughts about the document, although not for the reasons enunciated by March. In a recent book, Mosso noted:

The conceptual framework did nothing to establish operable recognition criteria. More importantly, the framework did not even try to eliminate choice of methods . . . . The FASB identified five “measurement attributes” in the then-current accounting model and said: “The Board expects the use of different attributes to continue.” That was in 1984. The attributes are still with us. The five attributes listed were: Historical cost, current cost, current market value, net realizable value, and present value of future cash flows. But five understates the problem. There are many variations of each. I have noted before that the most explosive choice in standard setting has been between historical cost allocation and fair value measurement. FASB wrestled with this issue throughout the development of its conceptual framework, but it concluded with this statement in CON 5: “Information based on current prices should be recognized if it is sufficiently relevant and reliable to justify the costs involved and more relevant than alternative information.” This is not a concept. It is a waffle.

(2009a, p. 34)

**Concepts Statement No. 6: Elements of Financial Statements, again**

Perhaps the most lauded of the seven Concepts Statements was No. 6, entitled *Elements of Financial Statements*, which was issued by unanimous vote in December 1985 as a supersession of SFAC No. 3. The reason for the updated statement was to expand its coverage to not-for-profit organizations. One article stated that the strength of SFAC No. 6 was its definitions: “[O] f all the Board’s concepts, the definitions in Statement No. 6 are the most robust” (Gerboth, 1987, p. 2). The essence of SFAC No. 6 was similar to SFAC No. 3, but there were many new paragraphs describing how the elements of financial statements that had been described in SFAC No. 3 also applied to not-for-profit organizations.
Concepts Statement No. 7: Using Cash Flow Information and Present Value

After a decade-and-a-half hiatus, the FASB issued another Concepts Statement in February 2000 entitled Using Cash Flow Information and Present Value in Accounting Measurements. Initially, SFAC No. 7 was supposed to define “fair value,” but the Board quickly determined that fair value was too much of an issue and agreement would be difficult in achieving. Eventually, the Board decided that a fair value statement would be impossible. Since present value was a major component of many fair value judgments, it was decided that a present value project would be helpful and was doable. Two Board members dissented to SFAC No. 7 because of its adoption of fair value as the sole objective of using cash flow information and present value in accounting measurements.

Concepts Statement No. 8: Conceptual Framework for Financial Reporting

In September 2010, SFAC No. 8 was issued as a replacement for SFAC No. 1 and SFAC No. 2. This document began as a joint project with the International Accounting Standards Board (IASB) with the objective of converging the respective frameworks of the two organizations. According to SFAC No. 8, the objective of general purpose financial reporting is “to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity,” which is consistent with what appeared in SFAC No. 1. However, SFAC No. 1 viewed potential investors and creditors as the primary user groups, while SFAC No. 8 considered this group to be resource providers and not necessarily the primary user group. This view indicates that there is a wide separation between business entities and the owners of those businesses. From a conceptual point of view, SFAC No. 8 is based more on the entity theory of accounting than the earlier owner-emphasis proprietary theory.

Another change appearing in SFAC No. 8 – one that emanated from the joint efforts with the IASB – was a reorganizing of some of the qualitative characteristics of financial information. The changes were small and perhaps subtle. Under the new view, materiality, for example, was changed from a quantitative characteristic relating to whether an item would influence investor decisions to being a subsidiary of the relevance concept.

Summary of the FASB conceptual framework

The FASB as an institution needed a conceptual framework. A framework is desirable, but not sufficient, for effective standard setting. According to Donald Kirk, “Sound concepts are essential guides for standard setters beset by lobbying and political pressures to distort what must be, to serve the public interest, an even-handed measurement system” (1988, p. 17). Thus, in addition to being a planning tool for the Board, a conceptual framework can be a defensive tool against the slings and arrows of the political process. The FASB’s conceptual framework is based on a number of sources, including the 1973 Trueblood Report, the APB’s Accounting Research Studies No. 1 and No. 3, and on Board members’ experiences in attempting to establish standards in the absence of a conceptual framework. Altogether, the framework is a body of concepts that were developed at different times and put together to form a whole. One British writer noted that the conceptual framework project gave birth to 60 documents totaling over 4,000 pages, which made it the most ambitious attempt to establish financial reporting guidelines ever undertaken (Gore, 1992). That writer also concluded that the results had been the subject of extensive criticism and little acclaim.
The verdict on the FASB conceptual framework has been mixed; even former Board members are often critical, or at least not enthralled with the results. As early as 1986, Board Chairman Donald Kirk mentioned in a speech that “Board members who were not involved in developing the conceptual statements seem to have less attachment to them or proprietary interest in them” (quoted in Gerboth, 1987, p. 6). Why has there been disappointment with the Concepts Statements? The FASB itself, in a December 1983 issue of its newsletter, Status Report, suggested that its constituents had “false hopes” that the framework would produce instant answers to the problem areas of accounting. Others, including several former Board members, argued that accounting already had all of the conceptual framework that it needed, and the FASB simply gave new expression to old ideas. Another argument that has been put forth is that the fundamental error of the conceptual framework is the mistaken idea that it is possible to avoid or control debate on a subject by prior agreement on abstract principles (Gerboth, 1987, p. 2). Other criticisms have included that the project was internally inconsistent, failed to take the economic environment into account, and was of little use to present or future practice (Gore, 1992). The political environment was also ignored; the framework does not recognize that standard setting is of a political nature. One 1992 study concluded that the successes had been limited to issues that were not controversial in the first place, and successful usage of the framework had not been evident with the more complex issues (Nussbaumer, 1992, p. 235). Former Board member Arthur Wyatt has stated that the framework is incomplete, and he wanted further revisions. Abraham Briloff, often a critic of the accounting profession, stated that the framework lacks any claim to being conceptual at all and has resulted in reduced academic input into the standard-setting process (Sweeney and Yaari, 1998, p. 41).

Although the idea that prior agreement on principles has intuitive appeal, such agreement has not always been true when the FASB begins discussing whether an item meets the definition of an asset or liability. Unfortunately, the result has often been an argument that the conceptual framework was incomplete; the item in question is an asset or liability despite the fact that it does not seem to meet the definition. The contributions of the FASB conceptual framework were summarized by one former staff member as follows:

In fairness, it cannot be said that the conceptual framework adds nothing. It may have failed to deliver on some of its promises, and it is almost certainly not worth the big bundle of bucks the FASB spent on it. Nevertheless, it did a reasonably good job of drawing together, organizing, and articulating the basic concepts of accounting, and that is no mean accomplishment. Used properly, the conceptual framework can enhance the process of setting accounting standards.

(Gerboth, 1987, pp. 7–8)

In 2005, the FASB decided to revisit the conceptual framework and added a new project to its agenda. The goal of the still-in-process project is to update and improve existing concepts and to fill in gaps in areas such as measurement, disclosure, and financial statement presentation. The project is being conducted jointly with the IASB with the objective of producing a single conceptual framework that can be used anywhere in the world. The progress of the new project is open to debate. In April 2009, Robert Bloomfield posted the following lines on a website:

Sometimes I think that differences of opinion on the importance of the Conceptual Framework are as wide as differences of opinion on the appropriateness of Fair Value Accounting. The debate isn’t as loud, though, because those who think Fair Value Accounting is inappropriate argue vehemently against it, while many who think the Conceptual Framework is not important just quietly ignore it.

(Bloomfield, April, 2009)
Gary J. Previts and Dale L. Flesher

Quietly ignoring the conceptual framework has been an easy way to deal with controversial issues. Alternatively, some critics argue that it is not that the framework is being ignored, but rather that the framework is too generalized to be useful in specific situations. According to one Board member, the framework is too vague to guide standard setting in any meaningful way. Alternatively, a staff member argued that the framework is widely used by staff members in framing their analyses for the benefit of Board members (Bloomfield, 2009). Such disparate views were first noted as early as 1981. In a November 24, 1981, memo, FASB Director of Research and Technical Activities, Michael Alexander, made the following observation about the conceptual framework:

The last pensions Board meeting indicated to us that the staff have a much better working knowledge of the conceptual framework than the Board do. The staff work with the conceptual framework on a day-to-day basis – some staff more than others. But the Board have difficulty remembering it even though they were the ones that passed it. Part of the reason for this is that concepts are hard to internalize when they require a change in fixed values or concepts that already exist. For many of the Board members, the new concepts in the conceptual framework replaced or contradicted or were different from their concepts of accounting that they had held for many years. So even though they were the architects and legislators of the new conceptual framework, without using it on a day-to-day basis they quickly forgot the detailed concepts that they had originated. The staff, on the other hand, had few prior biases to inhibit them and saw their job as accepting the concepts as stated and started to work with them as tools to do their job.

At this Board meeting, the conceptual framework was put out in front of the Board as a way of guiding the analysis of the pension accounting question. Board members again and again demonstrated their lack of familiarity and comfort with the framework. Some had forgotten that a liability could meet the definition of the liability and still remain unrecorded. That is, it needn’t be recognized even though it could be defined as a liability. Others claimed that there wasn’t any sense in defining a liability if you weren’t going to record it. The question of decision usefulness seemed paramount to some Board members but they forgot that they had produced a statement on qualitative characteristics of decision usefulness. Somehow the term had come to mean something other than relevance and reliability, comparability, cost benefit and so on. The whole meeting seemed to degenerate into disarray. The discussion resembled the Biblical tale of the tower of Babel. Those building the tower one day realized that they spoke so many different languages that they could no longer communicate to finish the job.

Needless to say, this is worrisome. Many Board members would like to choose to forget the framework or apply it in their own way. Their focus is naturally on the final solution. This kind of behavior does not auger well for the success of the FASB in developing a framework or making it stick as a useful tool in standard setting. There could be hope that the observers at this Board meeting were sufficiently confused by the discussion that they would not notice what was going on. But, unfortunately there were a few who well understood the problem. A representative of a large industrial corporation was later overheard to say, “Now that we have demonstrated that the conceptual framework isn’t good for anything, we can get back to the real questions.”

(Alexander, November 24, 1981)

Alexander concluded from the above that “you cannot teach old dogs new tricks; teaching Board members new concepts, or concepts that differ from the way they are accustomed to
doing things, appears impossible.” About seven months later, Alexander shared another view of the Board:

The prospects for changing the positions of Board members are probably nil and yet to admit this openly seems to be a rejection of conventional wisdom – that is that all people are malleable, fluid, or flexible in their thinking and open minded. It seems from watching this operation that the opposite is true. People are generally quite fixed in their thinking and like grain in a piece of wood, it is almost impossible to change them. There are, however, a few exceptions and this seven man Board has two of them.

(Alexander, June 18, 1982)

Although all members of the Board may not always use the framework, some observers have also suggested that constituents testifying before the Board or commenting on exposure drafts often do use the framework, “partly at least because they have discovered that they are more likely to influence the Board if they do” (Storey, 1999, pp. 1–110). The area of vagueness has opened up new opportunities for opponents and supporters of particular standards under discussion. The framework now serves as a tool that can be used to argue for or against proposed accounting standards. Terminology in the concepts is often so ambiguous as to support widely divergent views.

The old generation grew up with matching and historical cost. As a new generation becomes comfortable with fair values and a balance sheet oriented view of accounting, the FASB concepts could become more acceptable, and more fluid. Indeed, acceptance of new theories in the social sciences is usually a slow process. When writing about his own decision-usefulness concept, George Staubus wrote that “publishing a new theory in accounting is like dropping a rose petal in the Grand Canyon and waiting for the echo. An early start and good health increase the chances of seeing results in one’s lifetime” (2003, p. 163). Alternatively, perhaps David Mosso best summed up many individuals’ views of the conceptual framework project with the following lines: “My conclusion is that the conceptual framework was a useful step in accounting development but it has done all that it can. It is an anachronism and it is time to recognize that and move on to something better” (2009c).

Principles and standards

Over the years there has been criticism that US accounting standards are more detailed and complex than standards in other countries. The explanation offered is that US standards are more rules based, while those in other countries, including those promulgated by the IASB, are principles based. According to critics, rules-based standards have made it difficult for both preparers and auditors to stay current and have led to a “check-the-box” mentality “that encourages financial and accounting engineering to structure transactions around the rules to attain form-over-substance results” (Herz, 2003, p. 251). Also, many standards include numerous exceptions to the rules, which resulted from Board members adding compromises to assure an adequate number of votes or to accommodate the interests of particular constituent groups. As a result of the criticism over standards overload, the Sarbanes-Oxley Act of 2002 mandated that the SEC evaluate the feasibility of implementing principles-based standards.

The problem is that the FASB’s constituents have typically requested rules-based standards. It has been pointed out that the American economy is more litigious than in other nations. As a result, goes the argument, the US needs rules-based standards to stave off lawsuits. Rules-based standards create clarity; there are bright lines between right and wrong. With principles-based
standards, the lines are not as clear. Principles-based standards do not try to provide specific guidance or rules for every possible situation. The asserted potential advantages of a principles-based approach include enhanced professionalism in both the reporting and auditing of financial statements, easier-to-understand standards, reduced opportunity for form-over-substance structuring of rules since there would be fewer rules, and convergence with IASB standards that already use a more principles-based approach. Alternatively, there are disadvantages. One disadvantage might be reduced comparability, which could come about because of different good faith judgments about the correct accounting treatment. Even with the same facts, accountants could conceivably come up with alternative conclusions. Another disadvantage would be more difficult enforcement of standards. The SEC would be put in the position of having to make judgments about firm-specific interpretations of general standards. This would make the enforcement job more difficult, lengthier, and more subject to controversy than if the SEC could simply check to be sure that a registrant had followed a clear rule.

Many auditors and preparers recognize that to some extent they are protected from lawsuits if they follow the rules in rules-based accounting (Previts and Merino, 1998, p. 277). The rules-based standards provide a safe-harbor provision to auditors and preparers who make a good faith effort to apply accounting principles. A corollary to this is that with principles-based standards managers may feel less pressure to be constrained in their choices in the preparation of financial statements. There will be more opportunity for earnings management, and managers will likely seize these opportunities. Auditors will be put in the position of being unable to override management’s assertions unless the misstatement is so egregious that it produces evidence that can be used in court. Principles-based standards will result in greater professional judgment, but “professional judgment,” according to former Board member David Mosso, is a euphemism for “client choice,” and that is motivated by self-interest. Thus, the issue is not really rules versus principles, but choice versus restriction of choice and the degree of discretion that is left to management (Ketz, February 2008).

Some supporters of principles-based standards have gone so far as to suggest that rules-based standards lead to accounting scandals. In 2006, Graham Ward, the president of the International Federation of Accountants, claimed that detailed rules were “conducive to promotion of dishonesty,” whereas principles-based accounting led to “integrity, transparency and expertise.” In an op/ed piece, J. Edward Ketz called Graham’s comments “rubbish” (Ketz, March 2006). Ketz suggested that one reason for Graham’s perception was that fewer scandals were uncovered in other countries than in the US, and the reason for this was because the perpetrators in other countries were getting away with their frauds due to the lack of rules-based accounting. American perpetrators were more apt to be caught because of the availability of accounting rules. Ketz concluded his article with the following lines:

This discussion on principles-based accounting and its marvelous abilities to heal economic maladies remains unreasonable and indeed preposterous. U.S. society has some good forces that lead to greater apprehension of the bad guys, and it also has some dysfunctional aspects that tempt managers to commit securities fraud via accounting manipulation. As Graham Ward and others ignore these economic realities, they overlook social and economic variables that explain the incidence of accounting fraud in America versus the rest of the world. They overlook the explanatory variables and replace them with some dogma to justify their own agenda.

(Ketz, March 2006)

The question of principles versus rules is not a new issue; it is something that the FASB has been grappling with since its founding. Charter Board member Walter Schuetze addressed the subject
in a 1978 speech. Schuetze stated that all entities face this question – whether you are setting standards for a government agency, a private business, or your own home. He concluded that proceeding in either direction brings problems. The FASB examples he gave included the following:

If they write a very general standard, such as FASB Statement No. 14 on segment reporting, it is very difficult for preparers of financial statements and their auditors to interpret it uniformly. If they write a very specific standard, such as FASB Statement No. 13 on leases, inevitably some ingredient is left out or an extraneous ingredient is stuck in. Furthermore, people like to use their judgment and are averse to cookbooks that tell them what to do. . . . Some balance, some sense of proportion, is needed when acting in the real world, and those who set rules have to find the concepts that are consistent with the limitations the real world imposes. Well-formulated rules are somewhere between the very general and the very specific. I hope the Board will be able to find this middle ground.

(Schuetze, 1978, p. 8)4

Another 1978 supporter of principles-based standards was former Board member Ralph Walters. In a memo to other Board members, Walters wrote:

Standards should flow from concepts, economic logic, practice, and may even contain a dash of aspirations. But we, like regulators, tend to concern ourselves that people not be allowed to exercise judgment to implement a standard – judgment that might differ from ours. Therefore, we concern ourselves with heading off the perceived evil-doer, with plugging possible loopholes; and we get all tangled up in how-to when we should be concerned with what and why. We end up writing regulations. . . . Let the standard-setting body set standards. Let the regulators regulate.

(Walters, December 8, 1978)

Walters was of the opinion that the FASB should write standards and not worry about how those standards were interpreted by management; the SEC should write regulations and should worry about how management interpreted the FASB’s standards. In a 1983 speech, Walters questioned whether American accountants could even survive in anything other than a rules-based system:

We find regulators and standard setters whose attitudes and actions reflect the effects of thirty years of fire fighting and loophole plugging. They have become accustomed to it – like Brazilians have become accustomed to inflation and New Yorkers to noisy, dirty subways – it has become the norm and one seldom hears screams of outrage or see signs of resistance. Government regulators, in particular, are conditioned to press for more rules, more uniformity, less flexibility (read less judgment). Their frequent oversight attitude to the private standard setters, expressed or implied, is “if you don’t, we will.” . . . One result is that we have trained a generation or two who are conditioned to detailed rules. We have learned how to live with the letter rather than the spirit of the rules. We have learned that detailed rules can usually be subverted by a careful structuring of transactions. We have bred a generation of extremely sophisticated and talented loopholers. The typical reaction of standard setters, when loopholing (politely referred to as diversity of practice) is detected is to write more detailed rules to plug the loophole. But, it’s a losing battle – for loopholers are more creative and agile than standard setters – so we have an endless cycle.
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In late 2002, the FASB and the SEC began working on the idea of moving toward principles-based standards. A request for comments on the subject was issued in October 2002, and public roundtable discussions were held in December. One conclusion was that a movement toward principles-based standards could not be accomplished by the FASB by itself; it would also require major behavioral changes among other parties:

It requires preparers, auditors, audit committees, and boards to be willing to exercise professional judgment, to resist the urge to seek specific answers and rulings on every implementation issue, and to view accounting and reporting as an exercise in good communication that goes beyond mere compliance. It requires that investment bankers and the accountants and lawyers that work with them stop trying to invent ways to create products and structures to “loophole” standards, and it may require that the SEC staff temper their demands for bright lines to facilitate their review and enforcement activities. Moreover, it may require some changes to the legal and litigation framework surrounding financial reporting and auditing.

(Herz, 2003, p. 251)

By 1991, Schuetze’s views on principles versus rules had not changed much:

We have tried the simple approach that requires judgment. For example, in APB Opinion 5, the Accounting Principles Board said that lessees should recognize in their balance sheet those leases that are in substance installment purchases of property – those that result in creation of a material equity in the property. That was a general standard, requiring judgment to implement. It did not work. Very few leased assets and corresponding lease obligations were recognized by lessees. As a result, the Financial Accounting Standards Board issued very detailed, complex rules on accounting for leases in FASB Statement 13. But now, Statement 13, even with all its amendments and interpretations does not work. And, to make things worse, the Securities and Exchange Commission’s staff and the Emerging Issues Task Force keep adding layers of complexity to it.

Ketz attempted to summarize the issue of rules versus principles in his February 2008 article:

FASB and the SEC continue to take steps to implement a principles-based accounting standards-setting system. But questions and concerns still abound. What exactly is an accounting rule and what is an accounting principle? Why is complexity viewed as a problem but managerial lying and thievery are not? Where is the evidence that principles-based accounting will help investors? For some strange reason, FASB and the SEC ignore these annoying questions and continue with religious fervor to support their idol.

In a more recent article, Ketz verbalized what many observers have thought about the principles-based standards of the IASB:

I also find it ludicrous for so many practitioners to claim the superiority of IFRS [International Financial Reporting Standards] over U.S. standards. Such individuals should read and compare (say) lease accounting under these two systems. If they undertake this simple exercise, they will see that there is little difference . . . . As I have said in many columns, principles-based accounting is superior to rules if and only if these so-called accounting principles are implemented by principled managers. As too many managers don’t exhibit principles as
evidenced in their financial reports, I shall continue to believe U.S. rules-based standards are superior to principles-based ambiguities.

(Ketz, December 2009)

Perhaps a sometimes wearisome debate over principles versus standards was addressed sufficiently, if not resolved, in November 2003 at the 103rd American Assembly meeting, sponsored by Columbia University, where it was noted that the current debate about the future of accounting swirls around the issue of whether or not the profession should replace the rules-based system . . . with the so-called principles-based system favored by the IASB . . . The either/or debate over principles and rules-based accounting is, we believe, simply a proxy for a more important and subtle issue: to what degree do we expect the preparers and auditors of financial statements to exercise judgments?

With this to frame the discussion, the attendees favored fewer rules and more judgments. The discussion was summed up as follows: “The debate over rules-based and principles-based accounting is based on a false premise that the two systems are mutually exclusive. We believe they are tied together inextricably” (The American Assembly, 2003).

The Jenkins Committee report

Financial Reporting and Standard Setting, a symposium sponsored by the AICPA at the Wharton School of the University of Pennsylvania on October 25–26, 1990, was the event that served as the catalyst for the forming of the Special Committee on Financial Reporting chaired by Edmund Jenkins, then the senior technical partner of Arthur Andersen & Co. (Previts, 1991).

By 1994, the committee and its study groups had ranged widely into investigations of various practices and issues that were emerging in the capital market reporting environment of public companies. Innovative financial instruments, off-balance-sheet financing, separate highlighted reports being provided to institutional investors by public companies, and communication technologies with increasing global and instant reach had all combined to suggest that the old emphasis in both education and mainstream practice toward producing “financial statements” had passed. Innovative structures for the content of financial reports were developed at a never before considered level, namely as broader business reports reflecting non-financial performance or key performance indicators as well as traditional financial metrics.

The Jenkins Committee report included a ten-point information model, of which only one point was identified with traditional “financial statements and related disclosures.” Coming some twenty years after the Trueblood Report and being derived and hosted by a Wharton School Dean, Russell Palmer, who had previously served as the managing partner of the Touche firm, which Trueblood had also served in a similar capacity, seems like curious historical coincidence.

The ten elements of the Jenkins Business Reporting Model were parts of five major categories:

1. Financial and non-financial data
2. Management’s analysis of the financial and non-financial data
3. Forward-looking information
4. Information about management and shareholders
5. Background about the company
Not unexpectedly, the preparer community received the Jenkins model with coolness, seeing the proposal perhaps at best as another unfunded mandate, despite the research support that indicated a growing need for expansion of the information content of communications between corporations, capital providers, and society. Later, the Financial Executives Research Foundation produced an executive research report, issued in November 1999, indicating that sufficiency of such data, especially in the non-financial area, appeared to be based on comparative reports of key companies over the years. The study identified the manner by which management selects themes, the level of detail, and the structure of annual reports with the intention of conscientiously communicating with its constituents.

The Jenkins Committee report preceded and likely led to the appointment of Jenkins as chair of the FASB, following the two-term chairmanship of Dennis R. Beresford. At this point the Board initiated, under the watchful eye of FAF member Paul Kolton, former chair of the American Stock Exchange, and Board member Joseph V. Anania, a business reporting research project to study in depth and detail the reporting practices and information flow needs of financial analysts. The project, however, failed to gain broad support, and Jenkins left the Board position after one five-year term. The business reporting model’s inability to win support was but another example of the difficulty of bringing together the broad and various constituencies of the reporting community, preparers, auditors, analysts and investors, and regulators to support an agenda of change.

**Fair value accounting**

Some have blamed the disappointment over the outcomes of the conceptual framework project on the Board’s unwillingness to abandon historical cost accounting, “an ideological heresy that in some circles bears blame for everything from nuclear Armageddon to spastic colitis” (Gerboth, 1987, p. 1). Several former Board members have commented that the mongrelization of accounting makes it impossible to come up with an effective conceptual framework, since some accounts are shown at historical cost and others are reported at fair market values. Mosso summarized the relationship between the conceptual framework and fair value accounting:

I was supportive of the conceptual framework in its entirety because I thought, and still think, that it brought a good bit of order to the GAAP accounting model. It was the best we could do at the time and I am a believer in moving forward as long as there is a net gain. Also at the time, I was still enamored of the FAF–FASB model and thought we could make real improvements in accounting. Experience with the process — the inability to get anything done in a reasonable time frame and the continuing largely successful resistance to fair values and retention of the ability to manage earnings — reinforced by my experience with federal accounting, gradually eroded my support for both the accounting model and the standard setting process.

(2009c)

Statement No. 157, *Fair Value Measurements*, issued by unanimous Board vote in September 2006, defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements. Therefore, this statement does not require any new fair value measurements, and SFAS No. 157 does not represent a radical departure from previous accounting standards. Prior to the issuance of SFAS No. 157, there were several different definitions of fair value and little guidance for applying those definitions. These
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Differences in guidance created inconsistencies that added to the complexity of applying GAAP. In developing SFAS No. 157, the Board considered the need for increased consistency and comparability in fair value measurements and for expanded disclosures about fair value measurements. A fair value standard was 30 years in the making, albeit the concept itself is nearly ageless as noted below. Despite the fact that SFAS No. 157 introduced little in the way of new standards, it did amend, supersede, or otherwise affect more than 40 areas of accounting guidance, beginning with SFAS No. 13 on leasing. That was the first FASB pronouncement to introduce the fair value concept. Following SFAS No. 13, many other statements continued the move away from historical cost toward fair value, including SFAS No. 87 on pensions, SFAS No. 106 on other post-retirement benefits, and SFAS No. 133 on derivatives. However, many of these standards used the concept of fair values in different contexts. SFAS No. 157 was designed to provide a uniform definition of fair value that would apply in all cases. In summary, SFAS No. 157 did not require any new transactions to be accounted for at fair value, but it stipulated the framework to be used when other standards require the use of fair values.

In February 2007, the Board issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115. This statement permits entities to choose to measure financial instruments and certain other items at fair value. The objective was to improve financial reporting by providing organizations with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 157 was expected to expand the use of fair value measurement. This Statement applies to all entities including not-for-profit organizations. The portion that is an amendment to FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, applies to all entities with available-for-sale and trading securities. Some requirements apply differently to entities that do not report net income. The vote on SFAS No. 159 was not unanimous; both dissenters doubted that the statement represented a cost-beneficial interim step toward measuring all financial instruments at fair value – a long-term goal expressed by the Board in Statement 133. Instead, they believed users of financial statements would be better served by accelerating efforts to issue a statement requiring all financial instruments to be measured at fair value each reporting period with changes in those fair values reported in earnings.

Although fair value accounting, as professed in Statements of Financial Accounting Standards No. 157 and 159, is hardly addressed in the conceptual framework (although it was originally to have been a major part of Concepts Statement No. 7 and was what made Statement No. 5 so controversial), it is discussed here because fair value has been a part of the personal conceptual framework of some past and current Board members. For example, one of the charter Board members, Walter Schuetze, claimed that he resigned from the Board because not enough of the other Board members shared his penchant for fair values. However, more recent Board members have included fair value in their personal conceptual frameworks. In particular, since the early 1990s the Board has accepted the responsibility of moving toward the use of fair values to the extent possible. Unfortunately, fair value is sometimes difficult to determine. One advantage of historical cost is that it is an objective measure (albeit not after the date of purchase), but fair values can also be objective. With the issuance of Statements No. 157 and 159, the FASB officially moved to fair value reporting. However, with the decline in the mortgage market in 2007–2008, criticism arose that fair values do not work in illiquid markets. Arguments against fair values have included the fact that fair values in an illiquid market underestimate the “true value” of assets (but critics have not defined true value).

The concept of fair value accounting did not grow in a vacuum; it has been around in a conceptual mode for decades. Henry Rand Hatfield mentioned the use of current costs in a
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1909 book but suggested that historical costs were a more appropriate valuation method in most circumstances. Economist J. B. Canning supported the use of exit prices for valuing assets in his classic 1929 book, and in 1939 Kenneth MacNeal went so far as to say that truth in accounting can only be achieved when financial statements report the current value of assets and the income or loss from changes in those asset values. Similarly, the Paton and Littleton monograph mentioned the topic in Chapter 7. Edwards and Bell had argued for the use of replacement costs in their 1961 book, while George Staubus advocated in his 1961 book the use of the present values of future cash flows. Chambers’ 1960 exposition of continuously contemporaneous accounting (COCOA) led to him being viewed by many as the apostle of fair value accounting. Chambers (1966) and Sterling (1970) had somewhat similar theoretical proposals involving the use of exit prices for valuation purposes. Even the Trueblood Committee report that came out in 1973 mentioned that current values should be used if they differed significantly from historical costs. Thus, even though the typical practitioner might have been unfamiliar with fair value accounting, academic accountants and the FASB staff and Board were aware of the many proposals.

As early as 1977, the Business Roundtable lobbying group made up of corporate executives campaigned against fair value accounting. In a letter from Thomas A. Murphy of General Motors Corporation commenting on the first Conceptual Framework Discussion Memorandum, a section entitled “Cause for Concern,” the Roundtable noted:

We are particularly interested in a full discussion of the subject because we perceive an apparent drift toward the avocation of the incorporation of some type of current value accounting within the formal audited financial statements. This causes concern on our part because we believe such a change in the financial statements would, among other things, have a detrimental effect on the capital markets. . . . We fear that if the basis for reporting financial results is changed to some type of current value accounting, the result would be highly subjective financial statements, subject to different interpretations and possible abuse by various individuals with the result being a reduction in investor confidence.

(Murphy, June 24, 1977)

The 1977 Murphy letter went on in an attempt to educate the Board as to why current values were a bad idea. Murphy noted that:

except for the problem of inflation, we don’t believe this old accounting debate (which was decided nearly forty years ago in favor of the matching of revenues and expenses by such renowned accountants as Paton and Littleton) would have been raised again.

Murphy pointed out that businessmen and people in general are transaction oriented: “Selling a product or a service is the purpose of an enterprise, not holding assets or liabilities for a future ‘gain’ dependent upon the effect of inflation.” He went on:

We don’t believe that the balance sheet of a company was ever intended to be a representation of the market price of a company, which seems to be what some of the most vocal critics of accounting want. This can only be determined by a willing buyer and a willing seller through negotiation and even then the price might turn out to have been incorrect based on subsequent events. Certainly none of the current value methods which have been proposed can be considered to be a realistic representation of the supposed value of a company on a going concern basis.

(Murphy, June 24, 1977)
The Board issued an exposure draft of the first Concepts Statement in December 1977, which led to a July 26, 1978, Board meeting on the topic. In a letter to senior management at General Motors, Eugene Flegm reported that the FASB had adopted the so-called asset/liability view of the measurement of income instead of the matching concept, in spite of “overwhelming testimony and papers” in favor of the continuation of the matching concept. Flegm noted that the purpose of the meeting seemed to be “to assure people that the change to the asset/liability view does not represent the revolution in accounting that it has been presented to be” (July 31, 1978).

Flegm concluded that the Board believed that in the next ten to fifteen years historical cost would remain the basis for financial statements, but in the long run accounting would at some point be valued based. “Therefore, in viewing the conceptual framework of accounting today the concepts must be based on an asset/liability view as opposed to revenue/expense view because a valuation-based system cannot be supported under the revenue/expense view.” Flegm also observed that the Board understood that the asset/liability view and the revenue/expense view were not mutually exclusive; they often give the same results. However, if there was a conflict between the two, the emphasis on the balance sheet view would be selected over the income statement view. Flegm reported that in his testimony before the Board, he had concluded with the line that the Board “could not improve upon Paton and Littleton’s work of 40 years ago.”

The Business Roundtable campaign against fair value accounting had become even more aggressive by 1982. The minutes of the September 13, 1982, Business Roundtable Accounting Principles Task Force, held in New York City under the leadership of Roger Smith and Eugene Flegm of General Motors, indicate that the group had two specific areas of concern: “One was the apparent trend toward some type of value based accounting while the other was the emphasis on specific rule making as opposed to more general guidelines” (Business Roundtable, 1982). The basic conclusion was that the fair value approach was hurting the effectiveness of the accounting system, was unproven, and was difficult to implement. The financial statements would no longer measure the stewardship of management. The Roundtable must have thought that something had been accomplished at the meeting; Roger B. Smith, then the Chairman of General Motors Corporation, sent a letter afterward to Walter B. Wriston, Chairman of Citicorp, thanking him for his participation in the meeting and stating, “I believe we have laid the foundation for a greater appreciation on their (the FASB) part of the problems we in business face with financial accounting standards for reporting” (Smith, September 20, 1982).

Flegm was still arguing against fair values in 2005 when he wrote a letter to the Board commenting on fair value measurements. His contention was that fair values were to blame for some of the recent accounting frauds. He pointed out fair values were not auditable. This would be okay in a Utopian world, but in the real world some people are dishonest. According to Flegm, fair values place auditors in the untenable position of assessing management’s estimates of fair values. In a 2005 article Edward Ketz stated:

FASB likely will ignore Flegm’s comment. Indeed, the Board has become more or less immune to criticism as it lives in some toy universe in Connecticut. But, in the real world, investors must worry about the scruples of corporate managers and directors. After all, investors do not know which managers are ethical and who are crooks. Fair value measurements exacerbate the problem because they make it virtually impossible to discern the honest from the dishonest executives until it is too late.

(July 2005)

Illustrating the other point of view, in a speech delivered at the August 2009 American Accounting Association annual meeting in New York City, former Board member David
Mosso made the following statement: “FAS 157 is the only thing I will praise in the universe of generally accepted accounting principles (GAAP). FAS 157 is like the lone gold nugget in a miner’s pan of mud and gravel” (2009b). Mosso is not alone; more and more accountants are beginning to recognize that historical-cost-based financial statements are not the end-all that they once appeared to be.

What caused the change between the time when SFAC No. 5 and No. 7 were being studied and 2006, when SFAS 157 was approved? The FASB in 2006 was composed of people who had begun to employ and believe in approaches other than historical cost and the matching principle to a greater extent than the Board members of the 1970s and 1980s; the twenty-first-century Board members were more open to change. Also, the discussions of the early 1980s may have helped pave the way for some of the Board’s more recent standards. Even in 1984, there were only three Board members opposed to fair values. Perhaps the efforts of Robert Sterling and other academics, especially Robert Sprouse, who served on the FASB as a long-standing advocate of positions first outlined in ARS No. 3, as noted previously, seeking to establish fair values into the conceptual framework were not a failure; as times changed, new Board members became less protective of the historical cost concept and more willing to accept relevance and its value implication as a goal.

David Mosso, who was on the FASB Board during the promulgation of the first six Concepts Statements, summarized the situation this way:

I helped build the conceptual framework model. It was a giant step forward in the development of the theory and practice of accounting. But the framework was built in word-to-word combat with the business community and the framework came out of combat with a bit of post-traumatic stress disorder, which is manifested by nightmares in the form of contorted accounting standards.

Every accounting standard adopted before and after the conceptual framework has gone through the same kind of combat as the framework itself. FAS 157 could be called the Iwo Jima of accounting warfare. It planted a flag on top of a hotly contested fair value hill symbolizing what should be, I contend, the beginning of a transition from an undisciplined legislative style accounting model to a disciplined economic measurement-based accounting model.

(2009b, pp. 2–3)

Some critics, mostly commercial bankers, have blamed fair value accounting, particularly the requirements of SFAS 157 and 159, for the market distress of 2008 and 2009. Some argued that fair value measures were not reflective of reality in that market prices would eventually rise and the written-down assets would eventually recover their original values. Historical cost, they contended, would allow the market time to recover, while writing down the assets under fair value accounting only served to make the business cycle deeper. In other words, the argument was that fair value accounting resulted in the financial statements being an influencer on the economy rather than merely a neutral measuring tool. The reaction from bankers was perhaps indicative that they did not know their own regulatory history. Prior to 1938, banks were required to use fair value reporting; the 1938 Interagency Accord abolished the use of current value accounting for investment securities in bank examination reports. The justification for the change was that the use of current market values caused banks to operate in ways that hindered economic growth. The use of fair values for reporting caused bankers to trade securities in such a way that interest rates fluctuated and markets became depressed. The argument was that the use of fair values causes banks to buy securities for short-term price appreciation (Johnson and Swieringa, 1996, p. 156).
Perhaps concerns were more about volatility or change than about the valuation model. On conceptual grounds, a 2007 article questioned whether financial statements should report the value of a firm, concluding that financial statements are never capable of truly showing the value of a firm, and therefore they should not be expected to do so.

Financial statements are of course an essential input into analysis for decisions of many kinds, including investment decisions – but they constitute only one input. Their goal should not be to measure the value of the firm, but something more modest and achievable: to make a historical record of transactions and then to present as accurately as possible a summary representation of the financial results of these transactions. As Robert A. Healy, the longest-serving commissioner in the SEC’s history, said in the 1930s, the purpose of accounting is “to make a historical record of events,” and further that “the purpose of accounting is to account – not to present opinions of value.”

(Pollock, January 18, 2007)

Such conceptual arguments also bolstered the position of the banks. Despite the criticisms, the FASB and many accountants advocating the concept of fair value accounting argued that to ignore current market conditions only serves to hide problems. Investors want the financial statements to report the current fair values of financial assets, whereas preparers whose assets might have to be written down would blame the cyclical and the outcome. In the past, the use of historical cost reporting has aided management’s use of discretion to plan when losses would be reported (i.e., when an asset is disposed of), but Statements 157 and 159 challenged the process of managing earnings and, thus, the bonuses based on earnings.

**Big GAAP and Little GAAP**

The accounting profession has long struggled with the idea that the financial reporting needs of smaller closely held businesses might differ from those required by large publicly traded companies. The work of the FASB supposedly focuses on the financial reporting of companies of all sizes. There is a popular belief that the FASB’s standards are developed primarily to affect the reporting requirements for larger publicly owned companies because the FASB’s source of cash is linked to recognition by the SEC. However, the AICPA Rules of Conduct specifies that the FASB is the purveyor of accounting standards for all businesses – large and small. Small companies, however, argue that they should not be held to the same standards as large publicly held companies because the cost of such compliance is disproportionate when compared to larger entities. Smaller companies, and their smaller audit firms, have regularly suggested the need for differential standards for their purposes.

For decades, it has been proposed that the same accounting standards should not have to be required for both groups. In the December 1972 edition of the Journal of Accountancy, even before the FASB began operations, two CPAs expressed frustration with GAAP requirements being applied to smaller organizations. A small-firm practitioner pointed out that local practitioners are aware that requiring smaller organizations to prepare a long list of noncompliance with GAAP can be so confusing to clients and users of their reports that they can become meaningless. A partner with a large regional firm suggested that clients are reluctant to pay for services that they see as providing no value to them or the related capital providers or the public. The partner went on to suggest that certain closely held companies should be exempt from GAAP requirements that are prepared primarily for the readers of publicly held company financial statements. In 1974, while discussing the necessity of duality in accounting standards for public
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and private organizations, Max Block, a former editor of *The CPA Journal*, stated that “the accounting standards should not have been made mandatory to public and private companies without exception.” Block argued that, in some instances, later exemplified in his article, they should have been made *optional* for private companies. A few years later, Block (1977) quoted John Burton, a former chief accountant of the SEC, to point out that public accounting is actually two professions. In one profession, the primary relationship is between the accountant and the client. In this situation, attestation is not as important because it is limited to capital providers who have a personal or direct relationship with the client. In the other profession, the capital is provided by the public and other outsiders. Burton had suggested that although a basic accounting model is appropriate for all preparers of financial statements, this is different from the need for specific detailed disclosures and comparability between financial statements. In referring to Burton’s statements, Block clarified his perspective that public corporations and non-public companies are actually more like *two types* of clients that should be sharply distinguished within the profession.

In contrast to the preceding opinions generally supporting separate GAAP for closely held businesses, James Naus presented the case for not allowing separate rules for public and private companies. First, he pointed out that allowing alternative treatments may weaken the position of the CPA in achieving fair presentation and full disclosure. A second point is that a private company may still interact with the public environment. For example, an organization may wish to compare itself with larger competitors or may later become a public corporation. Naus implied that CPAs associated with non-public organizations would do better to influence GAAP in a way that meets all reporting needs (Naus et al., 1974). As a result of the interest in the subject, the AICPA had several committees study the issue between 1976 and 1983.

**A compromise position**

In the mid-1970s, the accounting standards division of the AICPA studied the application of GAAP to smaller and/or closely held businesses. In reporting its findings, the committee distinguished between two sets of principles. First, there are principles that are used in the measurement process. The committee believed that this process should not be affected by the nature of the user of the information since confusion would result from similar transactions being reported on an inconsistent basis. Secondly, there are principles that regulate disclosure practices. The committee supported the idea that particular disclosures may depend upon the needs of the user or on other factors (Chazen and Benson, 1978).

The opposing perspectives described above received significant attention in the 1970s, leading to a comprehensive study supported by the FASB to provide detailed empirical data to aid in determining the possibility of having different accounting principles govern reporting by public and private companies. The findings from the study indicated that although accountants believed that a separate GAAP would be beneficial, bankers found GAAP-based statements useful for decision making and favored the continued reliance of all companies on one set of GAAP. No consistent opinion was found among managers (Abdel-Khalik, 1983). The Board finally concluded that it had entered an area that was long on complaints and strongly held beliefs but short on facts. The FASB followed in 1981 with a call for public comment on the matter and also commissioned a research study. The study was carried out by a University of Florida team headed by Rashad Abdel-Khalik and was published in 1983 under the title *Financial Reporting by Private Companies: Analysis and Diagnosis*. Contrary to the general argument that small businesses should be treated differently was the alternative view that small businesses should not be treated as “second-class” citizens; they should have the same standards as big companies. In addition, the FASB special report included a principal finding that most lenders and other creditors feel
“that their financial information needs and decision making practices are essentially the same for private as for public companies” (Abdel-Khalik, 1983). This latter view was borne out by a 1985 poll by Louis Harris and Associates that found a relatively high level of acceptance of FASB standards by executives of small companies. The small companies saw in the standards “a level playing field” on which they could compete for capital against larger organizations (Van Riper, 1994, p. 94). The FASB established a Small Business Advisory Group in 1984 and agreed to explicitly examine the implications to small businesses of all future standards projects. In 2004, the Small Business Advisory Committee was founded to meet twice a year to allow members to share their thoughts with the FASB. In 2007, the Private Company Financial Reporting Committee (PCFRC) was formed to represent all non-public business entities, regardless of size. The PCFRC gets its administrative support from the AICPA.

The 1983 study by Abdel-Khalik settled the issue for a few years, until 1995 when the AICPA’s Private Companies Practice Executive Committee (PCPEC) concluded that standards overload is one of the most significant concerns of members practicing in small firms (Burke, 1997). However, the issue of separate GAAP for private companies was again rejected when the conclusion was reached that allowing a new basic accounting method would only contribute to the perceived standards overload problem. It was therefore recommended that the best approach at that time would be to have “the Financial Accounting Foundation (FAF) make a concerted effort to recruit and select trustees, FASB board members, and FASB staff persons who have experience with and understanding of the needs of small non-public entities” (AICPA, 1996). In fact, The CPA Journal had reported just a few years earlier in 1989, that the Private Companies Practice Section of the AICPA Division for CPA Firms promoted other comprehensive bases of accounting (OCBOA) as an alternative for small businesses to meet financial reporting needs in certain situations, but not as an alternative form of GAAP. After the turn of the twenty-first century, the AICPA (2005) noted that no in-depth study of the issue has been conducted in recent years. This concern led to the 2004 study described below.

Despite the above-mentioned support from the small business community, the FASB has occasionally addressed the issue of whether the same standards should apply to both small businesses and large corporate entities, and FASB decided that differential reporting would be acceptable. In some cases, the Board has limited the applicability of a standard to only larger entities. For example, under the provisions of SFAS No. 21, small non-public companies were exempted from the requirements to report earnings per share. Similarly, SFAS No. 14 on segment reporting did not apply to smaller companies. SFAS No. 14 defined a non-public company as one whose debt or equity securities do not trade on a stock exchange or in the over-the-counter market or one that does not have to report to the SEC. When SFAS No. 131 superseded No. 14, non-public companies were again exempted from segment reporting. Small companies, including some public companies, were also exempted from the requirements of SFAS No. 33 on inflation accounting. That Statement applied to only about the 1,500 largest companies according to certain size criteria.

SFAS No. 79, Elimination of Certain Disclosures for Business Combinations by Nonpublic Enterprises—An Amendment of APB Opinion No. 16, was specifically issued to relieve small companies from some of the disclosure requirements of APB Opinion No. 16 on business combinations. That statement eliminated the obligation of non-public companies to disclose pro forma information for business combinations accounted for under the purchase method. Disclosure requirements for public companies were not affected by the pronouncement. SFAS No. 79 was the result of FASB research and a survey of practitioners on financial reporting by private companies. Participants in the studies often mentioned requirements that they felt should not apply to non-public enterprises, including the pro forma information required by APB Opinion 16.
The FASB decided that the costs of providing the pro forma disclosures normally exceeded the benefits for the typical users of small company financial reports.

Another example of differential reporting for large and small entities is illustrated by SFAS No. 126, approved in December 1996, which exempted non-public entities from the market value disclosure requirements of SFAS No. 107. To qualify, a non-public entity must have less than $100 million of assets and no derivative financial instruments outstanding. This was a standard wherein the FASB was experimenting with differing disclosure standards for smaller entities. Disclosures about financial instruments were made optional for entities that met the criteria. Most Board members did not think the issue particularly important.

The issue of Big GAAP/Little GAAP has been a pervasive issue throughout the history of the FASB but has never been properly solved in the minds of smaller constituents. Yet the FASB has addressed the issue and has typically made the decision that small companies should subscribe to the same accounting principles as larger entities. Board Chairman Robert Herz was asked whether there should be a defining line based on some factor such as size of equity or amount of revenue. His response serves as a summary of the issue:

I’m not in favor of wholesale big GAAP/little GAAP. Any differences should be based on user needs and cost/benefit considerations. We don’t need a two-tiered system for the sake of having one; it only creates more complexity. The FASB is primarily interested in the delineation between public and private companies.

(“FASB Chair . . . ,” 2008, p. 17)

The controversy of Big GAAP versus Little GAAP arose again in the twenty-first century. The AICPA’s Private Company Financial Reporting Task Force began comprehensive research in early 2004 to consider whether:

- The general purpose financial statements of private companies, prepared in accordance with GAAP, meet the financial reporting needs of constituents of that reporting; and whether
- The cost of providing GAAP financial statements is justified compared with the benefits they provide to private company constituents.

The AICPA Task Force concluded that some of the constituencies in the 2004 study are of the opinion that it would be useful if the underlying accounting for public versus non-public (private) companies were different in certain situations. This may be attributed to the fact that some GAAP requirements for public companies are perceived to lack relevance or decision usefulness for private companies. However, the Task Force also found that although respondents rated certain GAAP requirements as being low on decision usefulness or relevance, respondents appear to believe that the benefits of complying with GAAP outweigh the costs. This apparent conflict may be explained by the feeling that favorable ratings are given regarding the overall value of GAAP (AICPA, 2005). The Task Force also concluded that allowing GAAP exceptions and other bases of accounting are not the appropriate response to addressing the unique needs of private company financial reporting. Task Force members believed that such an approach would erode the overall recognized value of GAAP, while other bases of accounting might not adequately serve the needs of the constituents of private companies.

The issue is still being considered. In December 2009, a blue-ribbon panel of eighteen members was organized as a joint effort by the Financial Accounting Foundation, the AICPA, and the National Association of State Boards of Accountancy to provide recommendations
on the future of US standard setting for private companies. In December 2010, the panel announced a recommendation to the Financial Accounting Foundation that a new private company standard-setting board be established. The mission of the new board would be “to establish exceptions and modifications to US GAAP for private companies, while ensuring that such exceptions and modifications provide decision-useful information to lenders and other users of private company financial reports” (Defelice, 2010). In the event that such a board is eventually created, there arises the problem of how it would be financed, since money from the PCAOB could not be used to finance standard setting limited only to private companies.

As stated by Robert Herz, “Private companies are a vital force in the nation’s economy and it is, therefore, critical that their financial reporting be conceptually sound, cost effective, and provide relevant, reliable and useful information” (Zanzig and Flesher, 2006). This does not mean that there should be two sets of GAAP requirements that do not share some common components. Although there have been some standards that differentiated between private and public companies, most standards apply universally to firms of all sizes and organizational structures. The question of Big GAAP versus Little GAAP has often been considered by the Board in its deliberations, but only in a few cases have separate reporting standards been recommended.

As the FASB learned in the 1970s, this is an area with occasional loud complaints but little in the way of organized agreement across all constituencies. In general, the FASB and its constituencies seem to have agreed that a single inclusive set of standards was best for users of financial statements. Then came the post-2008 “great recession” cost-benefit perfect storm, leading to the creation in May 2012 of the Private Company Council within the institutional framework of FAF to address concerns about unwarranted reporting and disclosure requirements for small and medium-sized entities (SMEs). The focus now seems to be shifting toward a debate about a conceptual framework for SMEs.

With respect to international standards, the IASB in July 2009 published an International Financial Reporting Standard (IFRS) designed for use by SMEs. That standard was the result of a five-year development process and extensive consultation with SMEs worldwide. The reason given in support of the standard was that since full IFRSs were designed to meet the needs of equity investors in companies in public capital markets, they contain a sizeable amount of implementation guidance and include disclosures appropriate for public companies. Users of the financial statements of SMEs do not have those needs. Also, many SMEs say that full IFRSs impose a burden on them that has grown as IFRSs have become more detailed and as more countries have begun to use them. Thus, in developing the proposed IFRS for SMEs, IASB’s twin goals were to meet user needs while balancing costs and benefits from a preparer perspective. The objective of the project was to develop an IFRS to meet the reporting needs of entities that do not have public accountability. Future IFRSs for SMEs will be derived from full IFRSs with modifications based on the needs of users of SME financial statements and on cost-benefit considerations.

**Twenty-first century political developments (Gramm, Leach, Bliley): Financial Services Modernization Act of 1999**

In the belief that scaled-up financial institutions would benefit the position of the United States in global capital market activity, and that the proliferation of smaller financial institutions was a bane to efficiency, President Clinton signed into law in November 1999 a sweeping deregulation bill sponsored by three Republican members of Congress. The Gramm-Leach-Bliley Act (GLB), also known as the *Financial Services Modernization Act of 1999*, rescinded the limitations on combination of financial institutions prohibited since the passage of the 1933 Glass Steagall
(GS) banking law during the early days of the Great Depression. GS had divided the investment banking and commercial banking sectors under the view that each of these institutions had different missions in the capital market, and the degree of risk related to each sector warranted separation of their functions.

GLB, coming upon the conclusion of arguably the greatest period of market wealth creation in history, the 1990s (when the equity market indices increased by a multiple of several times from the decade opening level in 1990), suggested that it was time to consolidate financial institutions in a manner that would take fullest advantage of incentives to properly place resources in their respective marketplace. The institutional changes in the financial sector that followed had in many ways already manifested themselves due to lax enforcement of GS and seem to have become more clearly reflected in the considerations of the conceptual framework. As previously noted, SFAC No. 8 (2010) indicated a preference for the entity versus the proprietary view or orientation.

This may reflect a view toward providing information that portrays the assets of the entity in a manner that serves the short-term versus longer-term investment horizons of larger, diversely invested financial institutions, which are often selected as intermediaries for their ability to demonstrate short-term versus long-term performance gains. A focus on the short term versus the long term, with an emphasis more on liquidity than operating performance, as noted by Rappaport (*Saving Capitalism from Short Termism*, 2011) seems reflective of institutional behavior, especially in the wake of the strife of the marketplace in the latter half of the first decade of the twenty-first century. The emphasis is on immediate, liquidity-related value versus performance metrics from operations and, as observed by the *Economist* as early as May 1990, institutional investors demonstrate limited interest in serving on boards of directors of investees and behave more like “punters” than proprietors. In SFAC No. 8, the FASB signaled a position in support of the entity view, which considers the sourcing of capital to be indistinguishable—that is, the distinction between debt or equity is mostly a legal distinction. In a proprietary model, on the other hand, the focus is longterm risks and rewards to the residual risk holder who is the equity or proprietary capital contributor. Thus, there are important distinctions between the entity and the proprietary view. By staking out an entity view, SFAC No. 8 in 2010 established the conceptual groundwork for adjustments to disclosure consistent with the former, and not the latter, orientation. The issue then becomes, “What are those differences and how do they affect preparation, auditing, disclosure, and analysis?”

**Sarbanes-Oxley Act (2002)**

The Sarbanes-Oxley Act (SOX) of July 30, 2002, was transformative for the FASB and possibly for standard setting per se in that the funding previously provided by private sources is now undertaken by means of an annual fee assessed upon publicly traded companies. The FASB’s budget is subject to review and approval by the US SEC. This shift in sourcing was hailed by many as a reduction of the influence of private-sector constituencies who could apply pressure on the FASB in exchange for financial support—a factor affecting the appearance if not the fact of its ability to act independently. A competing criticism is that an agency supported by public funding is even more directly under the aegis and influence of the SEC, the federal government, and public and political processes. In indirect but important ways, the Financial Accounting Foundation, the parent organization of the FASB, is subjected to oversight, for example, in the vetting of candidates for seats on the FAF, where finalists are “interviewed” by one or more members of the Commission.

SOX also established the Public Company Accounting Oversight Board (PCAOB), which for the first time placed a private entity outside the CPA profession’s direct influence in the
position of reviewing the work of public company auditors. The PCAOB, while not a governmental agency, submits its proposed standards to the SEC as a part of the protocol for final adoption.

These changes seemed likely to influence the activities of standard setters and auditors, given the explicit role played by the SEC. As well, additional requirements were placed on preparers to affirm financial reports and for the review of internal controls. The post-SOX standard-setting and auditing environment is now arguably a domain not dominated by the private sector. For while the SEC has always been an influential observer at FASB meetings since its inception, formal budget involvement explicitly relates the FASB’s actions to the political process and the public policy direction of the Commission, whose members are appointed by the President. The implications of this may not be easily or even readily identifiable in particular standards but, as noted in the case of GLB legislation, may be supportive of the rationale supporting an entity versus proprietary view of reporting as indicated in SFAC No. 8. As yet however, it is not apparent that SFAC No. 8 has explicitly affected standard setting. As former Representative Michael Oxley stated in public forums in the years following the Act, with full agreement from his coauthor colleague, retired Senator Paul Sarbanes, the principal objective of SOX was to “restore” confidence in the public capital markets. With such a broad public policy objective, how its provisions are interpreted and enforced leaves substantial room for discussion as to implications for standard setting.

Dodd-Frank Act (2010), conflict materials, and political use of reporting rules

A mammoth legislative undertaking during the first years of the first term of President Barack Obama was the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (DF). DF mandates an unprecedented multiyear rule-making process involving over 200 new regulations for as many as a dozen regulatory agencies. A novel disclosure requirement enacted in DF affects publicly traded companies under the oversight of the SEC and creates a so-called EXTRA GAAP disclosure, one not established or endorsed by the FASB. The SEC rules mandated by the Dodd-Frank Act require disclosures by public companies concerning conflict minerals that originated in the Democratic Republic of the Congo or an adjoining country. The concern is that miners of these minerals in that region have adopted abusive labor practices. One study suggested that the aggregate cost to comply with the Dodd-Frank Act’s conflict minerals rule could run close to $8 billion, much greater than the SEC’s $71.2 million estimate.

In this way, indirectly, Congress has preempted FASB in a matter of social disclosure, consistent with the so-called triple-bottom-line framework advanced by many who are concerned about corporate social responsibility as well as financial or economic measures. These disclosures will require involvement of company auditors as to the processes by which such information has been gathered in order to substantiate that the representations being provided about the sources of conflict minerals are properly identified. Given that the FASB’s conceptual framework is narrowly focused on financial and similar metrics, since it failed to adopt a broader business reporting model as recommended by the Jenkins Committee, the SEC’s final rules released in November 2012 affirm that the standards for disclosure regarding conflict minerals is the responsibility of the US Government Accountability Office. Another consideration is the definition of the “user” of such disclosures. Presumably, the user will not be investors or financial analysts, but probably the US Department of State. Thus, financial reporting, and therefore financial reporting standards, are being taken over by politicians who are trying to promote an agenda of which corporate financial statements were never designed to be a part.
The codification project

Given the great number of standards that have emanated from the FASB, AICPA, and the Emerging Issues Task Force (EITF) over the years, many on similar topics, it is obvious that users have been a major beneficiary of the recent standards codification project. Before the codification project began, it was noted that there were at least 180 different pronouncements dealing with revenue recognition – many of which had emanated from the EITF. Determining which pronouncement was relevant in a particular circumstance was nearly impossible. This difficulty led to the onset of the project to codify all pronouncements of the FASB, APB, CAP, EITF, the AICPA’s Accounting Standards Executive Committee (AcSEC), and the SEC. In the summer of 2004, the trustees of the FAF approved the largest and most expensive project ever undertaken by the Board – the codification of all accounting standards. A computer-based searchable codification was completed in early 2008 and became official on July 1, 2009. A wide variety of viewpoints have developed about this technological application, from facilitating and supporting effective research to dumbing down judgmental processes to a level of mechanical dependency.

While the codification project did not “change” accounting standards, it has reordered and re-identified them by a classification scheme that uses section numbers, and not topics, to identify the subject under consideration. The availability of the codification may reduce criticisms related to standards overload. There are still as many standards as ever, but the overload, it can be argued, may be less noticeable with the organization and simplification provided by the efficient and searchable codification. Prior to the codification, many accountants thought all they had to do to solve a problem was to look to the previously approved FASB statements; they often ignored, or were not aware of, all of the other sources of GAAP. Codification may foster research; indeed, familiarity with the Code may afford facility in responding to some computer-based CPA examination questions. The codification of standards resembles in some ways the codification of the law, and it may be an indication that knowledge about principles is less of a focus than mastering the techniques of searching a “Code Structure.”

At the outset of this essay a number of questions were posed: What are important episodes and aspects of accountancy in this period? Is a philosophy of American pragmatism in accounting thought an explanatory element in these episodes? Is a regulatory maxim of sunshine or disclosure a prominent framework as an effective social remedy for the tension between the public and large economic entities that deploy major amounts of capital in the economy? These questions may now be further summarized into a single query: What are the signature aspects of American financial accounting and reporting that you as a reader have discerned about this period?

Summary and observations

Over the past two centuries, perhaps scores of millions of words have been written by individuals who would profess to be associated with the development or instruction of accounting thought and process in the United States. So it is ambitious, to say the least, to attempt to condense or distill so much in so brief an essay as this one. And yet proper summaries are needed to provide perspective for an appreciation of those events that occur outside the bounds of one’s own memory and experience. Furthermore, institutions in the accounting discipline, as is often the case in the peculiarly future-oriented American social fabric, tend to be forward looking and somewhat dismissive of history. Perhaps that is why there is a taste of rechauffe, or recooking, of the variety of flavors of the so-called framework debate over long
decades of change in technology and technique that makes one impatient for— or worse, truly expectant of—a resolution to the quest for the conceptual framework instead of a conceptual framework. The term itself, framework, invades the senses with a preconception of form and solid purpose, which betrays the subjective nature of the process of providing information that both protects those who have invested capital in an enterprise and those who might soon do so. What can be said is that the form and format of disclosure over the period has indeed changed, from the locked proprietor’s ledger balance of accounts, to the crude balance sheets found in antebellum railroads, the first large capitalizations in the US, to the iconic examples found in the multiple eras of US Steel annual reports, wherein the income statement and, ultimately, “matching” dominated an era of large industrials and their financial statements. Thereafter, the focus shifted from financial statements to a Trueblood Report orientation focused on financial reports to a broader business reporting model, as envisioned by the Jenkins Committee, which was influenced by web-based technology and instant global communication. There is in all of this perhaps one central assumption or belief that traces back to the sunshine era of the post-Civil War period, which first sought uniformity in what was to be disclosed. Thereafter the SEC sought not uniform disclosure but full and fair disclosure. Currently there are viewpoints which widely proclaim that disclosure should be “transparent” and concerned about “sustainability”. These evolving states presume that disclosure will affect decisions in a way that is consistent with economic and social well being. Belief in sunshine (or disclosure or transparency) as a social remedy assumes that the parties whose investment capital is ultimately at risk and who are given such information are capable of understanding and acting upon it. The frequently affirmed low levels of popular financial literacy seem to make this a tenuous premise.

Does a conceptual framework exist that will meet the needs of a complex global multicultural society? Will an eventual consensus or intellectual alignment occur as to the objectives and purpose of standard setting in the United States? And will it eventually be “endorsed” by other sovereign nations in some form? In 2002, the Norwalk Agreement between the FASB and IASB held forth the bright promise of “a single set of high-quality accounting standards” to be used globally. But over a decade later, following a July 2012 non-decision by the SEC—the agency that gives voice to the sovereign US government in such matters, no basis exists for expecting a mandate to adopt IFRS. The failure to achieve convergence probably surprises no one, and yet the expectation of discovering the conceptual framework continues to tantalize those engaged in discharging the substantial responsibilities of constructing standards for reporting that have the potential of casting out the shadows of darkness and opening up the full light of disclosure sunshine, the hope of which has been so brightly promised for over a century.

**An orientation postulate and the framework**

The first level of D. R. Scott’s (1931) framework is an orientation postulate that articulates between the environment in which accounting operates and accounting principles. While an orientation postulate as an essential element of a theoretical framework is becoming acknowledged, the need for an orientation postulate was not widely recognized in the 1930s. Scott, in his *Cultural Significance of Accounts*, contended that unity in accounting comes from a broad consideration of the social, political, and economic environment in which accounting serves. Years later, Zeff (1962), DePree (1989), and Stewart (1989) provided a similar argument that an essential element of a theoretical accounting framework is an orientation postulate. Zeff and, later, Lawrence and Stewart (1993), seem to argue that a conceptual framework must include the perspective from which accounting reports are to be prepared. Separating
a reporting framework from the accounting framework may seem specious to some, but the distinction between the goal of accounting to meet stewardship and fiduciary roles and the goal of reporting to assist decision making seems necessary if not vital. Writing in 1961, Davidson and Trueblood, Staubus and others, made an argument for the importance of decision making as a key to a disclosure framework. Davidson and Trueblood also noted that decision making shared prominence with “stewardship.” Can stewardship and decision making be reconciled in a single conceptual framework?

Could it be that this integration confounds what might better be structured as a separable accounting framework? And could it also be that the Lee (2006) and the MacIntosh (2006) commentaries on the saga of conceptualizing are most helpful in recognizing that a framework must first be considered as a socially constructed exercise?

John Kenneth Galbraith, a noted economist who passed away in the first decade of the twenty-first century, can be called upon to assist in understanding why the levels of frustration are so high and yet the effort toward a conceptual framework continues unabated. He said, “There is certainly no absolute standard of beauty. That precisely is what makes its pursuit so interesting.”

Lamenting the frustration of such pursuits does not serve us well. Recall again, that a conceptual framework is not authoritative. Perhaps in seeking and assessing frameworks, we should recognize that the value is not in achieving them but in undertaking and perfecting their pursuit. That is, the value of these efforts is to be found as much in the PROCESS, as in the PRODUCT.

Notes


2 The other five projects were (1) foreign currency translation, (2) accounting for leases, (3) segment reporting, (4) accounting for contingencies, and (5) accounting for research and development and similar costs.

3 Board members should have known Sterling’s views. He had published a 1970 book wherein he extolled the virtues of using exit prices for a company as a basket of goods, an aggregate valuation, as opposed to other writers such as Raymond Chambers (1966), who advocated individual asset valuation using exit prices.

4 It is interesting to note that Schuetze gave SFAS No. 14 on segment reporting as an example of a general standard. Two decades later, another Board viewed SFAS No. 14 as too rules based and opted for an even more general standard when it approved SFAS No. 131. Thus, one person’s general standard might be another individual’s idea of a rules-based standard.

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