Accounting Historians Journal

Volume 14
Issue 1 *Spring 1987*

Article 10

1987

Synopsis of essays on historical accounting topics published in the centennial issue of the Journal of Accountancy

Edward N. Coffman

The Accounting Historians Journal
Vol. 14, No. 1
Spring 1987

Edward N. Coffman
VIRGINIA COMMONWEALTH UNIVERSITY

A Synopsis of Essays on Historical Accounting Topics Published in the Centennial Issue of the Journal of Accountancy

In late 1985, members of the Academy of Accounting Historians were invited by Dr. James Don Edwards (University of Georgia) to participate in the centennial celebration of the American Institute of Certified Public Accountants in 1987 by submitting essays on historical accounting topics for possible publication in a centennial issue of the *Journal of Accountancy* to be edited by Dr. Edwards. In response to the invitation, a memorandum was mailed in December 1985, to all individual members of the Academy asking that they submit for possible publication in the centennial issue, essays on historical accounting events in the United States within the last 100 years that have had an impact on the accounting profession. The 600 word essays were received and anonymously reviewed by a committee composed of Academy members Edward N. Coffman, Gary J. Previts, and Richard G. Vangermeersch.

Due to the limited space devoted to these essays in the special issue of the *Journal of Accountancy*, only a small number of the many fine essays submitted were published. The following paragraphs contain a brief synopsis of each essay published in the centennial issue of the Journal.

"McKesson & Robbins" by Andrew Barr (Formerly Chief Accountant, SEC) and Irving J. Galpeer (Formerly Assistant Regional Administrator, NYRO, SEC).

The Securities and Exchange Commission case of McKesson & Robbins involving fraudulent disclosure of nonexistent assets and fictitious sales in the company's 1937 certified statements had significant impact on the public accounting profession. The adverse publicity resulting from the case shocked the accounting profession as it was the first time that the practices of the profession were subject to significant public and governmental disclosure, comment, and criticism. The profession would no longer continue to enjoy what then was relative obscurity in the public print. The McKesson & Robbins case resulted in expanding, standardizing, and initiating changes in auditing procedures including the confirmation of receivables, physical inspection of inventories, more intensive review of systems of internal checks and controls, emphasis of responsibility of auditors to public stockholders, and representation in the certificate concerning the scope of the audit work.

"The Payne-Aldrich Tariff Act of 1909" by Harold P. Roth (University of Tennessee).

In 1909, four years before the Sixteenth Amendment to the Constitution was ratified, Congress enacted the Payne-Aldrich Tarriff Act which was also called the Corporation Tax Act by accountants because the Act provided for an annual excise tax on the net income of a corporation. The Act created concerns for accountants in the areas of constitutionality and compliance. Two major compliance issues were the computation of net income and the depreciation deduction.

In 1911, the Supreme Court held that the Act was constitutional because the tax was as an excise tax on the privilige of doing business rather than a direct tax. The issue of calculating a tax on net income based on income received and expenses paid was resolved when the Commissioner of Internal Revenue issued regulations for complying with the Act. The depreciation deduction was an issue because many corporations had ignored it in the past. The Act also provided accountants opportunities in tax planning as many businesses changed from the corporate organization form to nontaxable partnerships or associations.

As the first income tax law to be held constitutional, the Payne-Aldrich Tariff Act provided accountants opportunities in the areas of tax compliance and tax planning. These opportunities were further expanded in 1913 with the ratification of the Sixteenth Amendment and thus form a major part of the profession today.

"Government Oversight — 1917: The Shape of Things to Come" by James J. Tucker, III (Rutgers University).

One of the earliest interventions of government into the practice of auditing and financial reporting occurred in 1917, when the Federal Reserve Board (FRB) issued the bulletin "Uniform Accounts." The document was initiated because the Federal Trade Commission (FTC) was concerned with the lack of uniformity and as a result enlisted the aid of the American Institute of Accountants (AIA) to help correct the problem. The joint efforts of the AIA, FTC, and FRB resulted in the publication of "Uniform Accounts."

"Uniform Accounts" was primarily concerned with "Uniformity as to the extent of verification" of accounts, i.e., the audit process. A step-by-step approach to auditing each balance sheet account was presented and a standard report-opinion was recommended. With the assistance of the AIA, the bulletin was revised and reissued in 1929 by the FRB as "Verification of Financial Statements." By 1929, the usage of the document had become so wide spread that it was referred to as the "accountant's bible." In 1936, the AIA revised and published the bulletin as "Examination of Financial Statements by Independent Public Accountants."

This early government effort was significant because of its impact on the practice of accounting and auditing and because of the working relationship that developed between the accounting profession and regulatory agencies.

"The First CPA Review Manual" by David R. Campbell (Case Western Reserve University).

Less than a year after the first CPA Examination, offered in Buffalo and New York City on December 15 and 16, 1896, the first CPA review manual, entitled *The American Accountants' Manual* (1897) was published by Frank Broaker, assisted by Richard M. Chapman. Broaker published the manual because it was felt that the general areas covered on the first examination would most likely form the nucleus of knowledge expected of future candidates. He also intended the manual to provide a focus for the academic preparation of those entering the profession.

The first of the two sections in the manual consisted of a reproduction of the 1896 CPA Examination questions and a discussion of the solutions. The second section was designed to provide academic preparation for those entering the profession and included commentaries on such subjects as balance sheets, statement of affairs, and scope of accountancy. In 1915, a second edition of the manual was published containing, in large part, the same information appearing in the first edition.

"Development of a Professional Code of Ethics" by Ashton C. Bishop (James Madison University) and Rasoul H. Tondkar (Virginia Commonwealth University).

This essay traces the evolution of the professional code of ethics for the accounting profession. The American Association of

Public Accountants first adopted ethical rules in 1905. The Association's 1906 bylaws, under the heading "Miscellaneous" contained two ethical provisions; a "Professional Ethics" heading was included in the 1907 bylaws and three additional rules were added. Despite interest in establishing a meaningful code, the profession was not successful because the Association was not in a strong enough position to make and enforce rules. Association policies were controlled by delegates from state societies who guarded states' rights; discipline was generally imposed by state societies and was ineffective.

In 1916, the Association was reorganized and renamed the American Institute of Accountants (AIA) and was given the authority by the membership to adopt and enforce rules of ethics. In 1917, the AIA adopted its first code of ethics containing basically the same rules in the 1906 bylaws and six additions. Since 1917, a number of changes have been made to the original code. In 1973, a conceptual foundation from which rules of conduct should flow was included in the code. Currently under consideration are changes to the Code of Ethics based on the recommendations of the AICPA's Special Committee on Standards of Professional Conduct that was established in 1983.

"The 'Other' Public Accounting Organizations" by Alfred R. Roberts (Georgia State University).

Since 1878, the American Institute of Certified Public Accountants (AICPA), under several different names, has been recognized as *a* national accounting organization. However, twice during the first quarter of this century the AICPA's status as *the* national organization representing the public accounting profession was seriously challenged.

The first challenge came in 1902 with the formation of the Federation of Societies of Public Accountants in the U.S.A. (Federation). The Federation was formed because even though the then American Association of Public Accountants (AAPA) was national in theory, in practice it was basically a New York City association. The Federation merged into the AAPA in 1905. The second challenge came in 1921 with the formation of the American Society of Certified Public Accountants (Society). The Society was formed because the AIA [AAPA's name changed to Institute of Accountants in the U.S.A. in 1916 and later modified to American Institute of Accountants (AIA)] was perceived to be in competition with the CPA certificate and was an eastern organization interested only in the problems of the national firms. Pressure mounted over the years to merge the two organizations;

however, it was not until 1936 that the Society was merged into the AIA. In 1957, the name of the American Institute of Accountants was changed by the insertion of the words "Certified Public."

"The Evolution and Current Status of Peer Review" by John B. Sperry, Edward C. Spede, and Donald W. Hicks (Virginia Commonwealth University).

Peer review is an integral part, if not the focal point, of the profession's self-regulation process, particularly, vis-a-vis the Securities and Exchange Commission. In response to critical review of its integrity and independence by the public and Congress during the 1960s and 1970s, the accounting profession undertook several measures to restore public credibility. For example, the American Institute of Certified Public Accountants (AICPA) established a practice review program in 1962 to uncover substandard practice and reporting and in 1974 it published *SAS No. 4* "Quality Control Considerations for a Firm of Independent Auditors."

However, criticism of the accounting profession's performance continued. In response to criticism in the 1976 Senate report of the Metcalf Committee, The AICPA created the Division of CPA Firms consisting of the SEC Practice Section and the Private Companies Section. This provided the AICPA a structure to regulate firms, with the foundation of this self-regulation being peer review. Peer review recognizes the firm, not the individual, as the practicing entity. To provide assurance that member firms possess and comply with a quality control system, they must undergo a review, performed by practicing CPAs, at least every three years. Included among the recommendations of the AICPA's Special Committee on Standards of Professional Conduct established in 1983 is the recommendation that all members in practice participate in a quality-review program.

"Who Should Formulate Accounting Principles?" by William D. Cooper and Ida B. Robinson (North Carolina A & T State University).

In the summer of 1937, the five Commissioners of the Securities and Exchange Commission (SEC) debated whether the SEC or the private sector should develop accounting principles. The three to two vote of the Commissioners in favor of the private sector developing accounting principles, had implications for the accounting profession for years to come. The personal philosophies of the Commissioners and the then Chief Accountant of the SEC, Carman G. Blough, concerning the development of accounting principles are discussed. Commissioners at that time were: William O. Douglas; Robert Healy; James Landis, Chairman; George C. Mathews; and J. D. Ross.

"From *Bercu to Sperry* — Significant Legal Landmarks in the Development of Tax Practice" by John C. Gardner (University of Wisconsin — LaCrosse) and G. A. Swanson (Tennessee Tech University).

Formal federal tax practice by accountants began in 1884 when the U.S. Congress provided that the Secretary of the Treasury may prescribe rules for recognizing agents, attorneys, and other persons representing claimants. The Internal Revenue Service (IRS) subsequently outlined standards for admittance and practice with reference to accountants, enrolled agents, and attorneys. Despite this federal provision, beginning in the 1940s legal suits were brought in several states to restrict the type of tax services that CPAs could offer clients. In 1948, the *Bercu* case sought an injunction against an accountant for giving tax advice to a client even though the accountant was not preparing the client's tax return or engaging in other traditional accounting work. The judge issued an injunction against the accountant for the practice of law by a non-lawyer; however, the judge implied that it was legal for an accountant to represent his client before the IRS even though the types of services the accountant could provide were not clearly delineated.

More suits were filed in efforts to sort out the rights and limitations of accountants and attorneys related to tax practice. In 1951, the National Conference of Lawyers and Certified Public Accountants negotiated and signed the *Statement of Principles Relating to Practice in the Field of Federal Income Taxation* to help delineate the responsibilities of each group in the tax area and recognize certain common areas of tax practice. From 1951 to 1963 the professional status of the CPA tax practice was progressively clarified and enhanced. The 1963 U.S. Supreme Court decision in *Sperry v. Florida* probably definitively established the right of CPAs to practice before the IRS in any fashion stipulated by the Treasury Department.

"A Turning Point in Tax History" by Tonya K. Flesher (University of Mississippi).

The 1934 *Gregory* tax case is discussed as having dramatically changed the course of tax practice. The case involved a reorganization solely for tax purposes in which Mrs. Gregory was allowed to receive appreciated property from her wholly-owned corporation without it being taxed as a dividend. The Board of Tax Appeals held for Mrs. Gregory because she had literally complied with the reorganization statutes; however, the Second Circuit Court of Appeals, in an opinion authored by Judge Learned Hand, rejected the literal interpretation and reversed the lower court ruling. Hand held that the statute presupposed a continuation of business and this intent was absent here; the unwritten requirements of the law had not been met. Hand looked at the intent of Congress and applied a business purpose test. This was the first time that a judge presented the business purpose test and the opinion that a literal interpretation of the law would not always prevail; Hand's views were adopted by the Supreme Court in upholding the ruling in this case.

The *Gregory* case established that mere compliance with the form of the law is not sufficient since there must also be strict adherence with the substance of the law. The principles of the case have withstood the test of time and remain a foundation of tax law which tax practitioners must always consider in structuring tax plans.

"Foundation of the National Municipal League" by Richard K. Fleischman (John Carroll University).

The National Municipal League (NML) was organized in New York City in 1894, when the municipal reform movement, which was to be one of the lasting achievements of the Progressive Era in American history (1893-1917), was in its merest infancy. At that time, a few state and local organizations existed; however, a capstone national organization was needed. The NML provided the necessary leadership and by 1900 it had 120 affiliate organizations and 600 others in correspondence. The NML worked strenuously toward the goal of uniform municipal accounting through its Committee on Uniform Accounting Methods (1900-1905) which was comprised of some of the leading accountants and academicians of the day, including Edward M. Hartwell, Chairman; Charles W. Haskins, Elijah W. Sells, William M. Lybrand, and Frederick A. Cleveland. The reaction to the Committee's recommendations were gratifying in that by 1904, the financial statements of eighty cities bore the stamp of the Committee's work.

It was through the NML and its Committee on Uniform Accounting Methods that accountants made a meaningful and lasting contribution to the Progressive movement. A solid basis was laid for the later articulation of standards for responsible municipal accounting.