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Elliott L. Slocum

Teresa T. King

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PAUL F. GRADY: CONTRIBUTIONS IN THE DEVELOPMENT OF ACCOUNTING PRINCIPLES

by

Elliott L. Slocum, Georgia State University

Teresa T. King, Georgia College and State University

Paul Grady's professional career spanned a period (1923-1968) in which accountancy possessed many leaders; men of ability, ambition, and vision. He worked with these men from public accounting, industry, government, and academics and earned his own place of prominence. As Previts (1986) said: "We have all been influenced by his work and students entering accounting classes are touched by his reasoning and his writings continually if indirectly." (p. 10)

Paul Grady's involvement in the development of accounting principles is examined in this paper with emphasis placed on the events during the period of 1955 to 1965 which led to the establishing of the Accounting Principles Board (APB, Board) and the Research Division and the publishing of Accounting Research Study, No. 7, *Inventory of Generally Accepted Accounting Principles for Business Enterprises* (Inventory, ARS No. 7). This paper is not a study of the contents or a critical evaluation of ARS No. 7 or of *The Basic Postulates of Accounting* (ARS No. 1) and *A Tentative Set of Broad Accounting Principles for Business Enterprises* (ARS No. 3).

Evolution of Principles

The phrase "generally accepted accounting principles" evolved during the work of the Institute's committee on cooperation with stock exchanges with the New York Stock Exchange to formulate a new audit certificate in which Grady had been involved. Grady said that it was a cooperating committee of the Controllers Institute of America, on which he served as a consultant, that suggested that the phrase "accounting practices" in the auditor's report be changed to "accounting principles." (Zimmerman, 1978)

After the establishment of the SEC, government intervention became a serious consideration. Initial congenial relationships between the SEC and the profession were frayed by 1936. Chief Accountant, Carmen Blough clearly indicated in a series of speeches that the SEC would not wait long for action on the part of the profession to deal with problems in financial reporting. (Carey, 1970)

The publication in 1936 of "A Tentative Statement of Accounting Principles" by the American Accounting Association (AAA) appeared to suggest a concept of a uniform code of accounting principles which had been formally rejected by the Institute. The profession responded with the publication of "A Statement of Accounting Principles," by Sanders, Hatfield, and Moore which had been commissioned by the Haskins and Sells Foundation to survey existing practice and to develop a "definitive statement of the best practice." The publication was criticized as an attempt by the profession to perpetuate existing practice. Some practitioners did use the study as a justification of current practices although the Executive Committee's approval of its issuance did not commit the Institute to the principles. (Previts, 1979) Far from enthusiastically received, it was the first relatively complete statement of principles based on practice and constituted the first major building block in the structure of accounting principles and determined to a great extent the form of the structure. (Storey, 1964)

The committee on accounting procedure (CAP) was expanded in 1938, and its research activities improved. The desirability of preparing a comprehensive statement of accounting principles was briefly discussed.

The CAP quickly rejected the approach because such an effort would take a long time to prepare and obtain agreement. "... , it seemed doubtful whether it would be feasible to prepare a statement of accounting principles that would be sufficiently comprehensive to afford a practical guide to settling any very large number of accounting problems. Accordingly, the committee decided to deal with specific areas of difference." ("History of the Accounting Procedure Committee—from the Final Report," November, 1959, p. 70) The Institute's executive committee urged the CAP to attempt a comprehensive statement of accounting principles in 1956, but without success. ("Accounting Research and Accounting Principles," December, 1958)

A Profession in Turmoil

Shortly after World War II, accountancy again experienced growth, a more complex business environment, aggressive governmental agencies, and increased concern by the general public about the quality of financial reporting. By the 1950s, accountancy was deeply concerned by criticism of financial reporting from within the profession and from leaders in business, government, and academics. Some believed that accounting practices such as the "cost principle" and "conservatism" overstated profits and misled the public. Others feared that public accounting failed in its social responsibility and believed that the public accountant should be a protector of public interest by reducing the many alternative methods and agreeing on a statement of accounting principles. (Storey, 1964)

Much of the criticism was directly or indirectly based on the perceived lack or inadequacy of generally accepted accounting principles. For example, Leonard Spacek (December, 1958) said: "Sometimes I am tempted to feel that the public accounting profession is acting the part of this small boy in trying to avoid or delay facing up to the inevitable necessity of defining generally accepted principles of accounting." (p. 40)

Representatives from industry

emphasized that lack of leadership on the part of the accounting profession would have serious consequences. They made it clear that many aspects of corporate financial reporting were in disarray. (Phillippe, December, 1963) Many were concerned that the establishing of accounting principles in the private sector would be replaced by government intervention. Some openly discussed whether the SEC's traditional constraint was in the public interest of investors. ("SEC Commissioner Seeks More Uniformity in Accounting Practice," March, 1963)

The New Approach

The Accounting Research Bulletins (ARB) were generally accepted as authoritative and approved by the SEC as a guide to practice. ("The Accounting Procedure Committee," September, 1959) The ARBs partially achieved the goal of narrowing the diversity of accounting practice. However, the piece-meal approach used by the committee was recognized as unsatisfactory, and the part-time status of the research efforts was inadequate. The CAP was also criticized because it failed to involve industry spokesmen and to provide for experimentation with new ideas.

The Special Committee on Research

Institute leadership knew that action was needed. Alvin R. Jennings, President of the Institute, proposed to the Institute in October, 1957, that the research program be restudied and made a number of recommendations regarding establishment of accounting principles. (Jennings, January, 1958)

The executive committee, in December, 1957, approved the appointment of a special committee composed of Weldon Powell, Chairman, Andrew Barr, Carman G. Blough, Dudley E. Browne, Arthur M. Cannon, Paul Grady, R. K. Mautz, Leonard Spacek, and William W. Werntz. ("Special Committee on Accounting Research Program," August, 1958) The distinguished nature of the special committee indicated the seriousness attributed to the criticisms of the profession. The special committee was charged to

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"...consider a new approach to the means whereby accounting research should be undertaken, accounting principles should be promulgated, and adherence to them should be secured." ("Report to Council of the Special Committee on Research Program," December, 1958, p. 62)

The special committee established the following foundation on which to achieve its objectives: (1) the general purpose of the Institute should be to advance the written expression of what constitutes generally accepted accounting principles, for the guidance of its members and of others, (2) the established generally accepted principles should be something more than a survey of existing practice, (3) the achievement of the objectives requires a continuing effort to determine appropriate practice and to narrow the areas of difference and inconsistency in practice is needed, (4) authority of the pronouncements should rely on persuasion rather than on compulsion, (5) the Institute can and should take definite steps to lead in thinking on unsettled and controversial issues." ("Report to Council of the Special Committee on Research Program, December, 1958) The recommendations of the special committee generally agreed with Jennings' proposals in October except in regard to the adjunct organization, funding, and binding authority of the pronouncements.

A structure for financial accounting was established that involved four levels: postulates, principles, and rules or other guides, and research. Postulates were to be few in number, basic assumptions on which principles rest, and derived from the economic and political environment and modes of thought and customs of business. A statement of broad accounting principles similar in scope to that issued by the American Accounting Association was to be formulated on the basis of the postulates. The principles and postulates would serve as a framework of reference to solve detailed problems. Rules and guidelines which were flexible and comparable to the current ARBs would be developed in relation to the

development of accounting principles postulates and principles. Pronouncements should be based on adequate research which is independent and gives consideration to all points of views. The research component was expected to produce a series of accounting research studies and a series of statements on generally accepted accounting principles. Statements would be issued by the APB and would be regarded as authoritative written expression of generally accepted principles. Only rarely should a pronouncement be adopted by the Council or the membership of the Institute because acceptance by professional accountants in advising clients and use in financial reporting was believed to be the best method of enforcement. ("Report to Council of the Special Committee on Research Program," December, 1958) The new research program had three distinctive features: (1) deduction was used to aid in the discovery of principles, (2) the reasons underlying the APB's position were to be made available, and (3) a serious attempt was made to unite practical experience and academic research potential and logical methods. (Storey, June, 1964)

As a member of the special committee on research, Grady participated in the development of recommendations which led to the establishment of the APB and the Research Division. Grady (May, 1962) believed that the Research Division should provide a useful medium for focusing the views and wisdom of the profession, in general, and particularly, the APB in the process of reaching conclusions regarding the accounting subjects studied. He recommended caution on the part of the APB in promulgating principles and encouraged a thorough consideration of the work of the Research Division before reaching a conclusion.

Postulates and Principles

Dr. Maurice Moonitz, University of California, was appointed as director of the Research Division, and Weldon Powell was appointed as chairman of the Accounting Principles Board. The Research Division
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embarked on its mission to establish the "Basic Accounting Postulates" and "Broad Accounting Principles" considered necessary as a foundation for the work of the APB and for further accounting research efforts. Moonitz agreed to conduct the research on postulates. Accounting Research Study No. 1, *The Basic Postulates of Accounting*, published in 1961, received a rather reserved response, with the attitude that it did not say much more than was self-evident.

Robert T. Sprouse was joined by Moonitz in the research of Accounting Research Study No. 3, *A Tentative Set of Broad Accounting Principles for Business Enterprises*, which was published in 1962. The project advisory committee included John H. Zebley, Jr., Andrew Barr, Carman G. Blough, Paul Grady, George S. Hills, and Hebert E. Miller. The negative response to the study certainly should have been expected, because it challenged the traditional cost basis of accounting and the revenue allocation model.

The Board stated that the studies were conscientious attempts to resolve major accounting issues but contained "inferences and recommendations in part of a speculative and tentative nature. ...while these studies are a valuable contribution to accounting thinking, they are too radically different from present generally accepted accounting principles for acceptance at this time." (Accounting Principles Board, April 13, 1962)

Grady believed that ARS No. 1 and 3 were too radically different from current practice to be acceptable to the profession at that time. Grady (August, 1964) and others disagreed with the theoretical/deductive approach, favoring the more familiar practice/inductive approach which was more appropriate in their view for solution of current problems in the practice of accounting. He believed that the approach taken in these studies deviated from the original mission of the Research Division.

Grady had submitted detailed criticism of an earlier draft. In addition, he prepared a lengthy statement which was included in ARS No. 3 and published in the May, 1962, issue of *The Journal of Accountancy* entitled, "The Quest for Accounting Principles." Grady, based on his experience with developing "generally accepted auditing standards," believed that development of "generally accepted accounting principles" would be more difficult and require more time than was given to the project. His primary position was that this project should be one of identifying principles for which there is presently general agreement and should not be a "discovery mission." Grady said that the Institute had the responsibility to establish an inventory of current generally accepted accounting principles before or at least separate from undertaking substantial changes. (Grady, May, 1962)

Reappraisal

Jennings (August, 1964) stated that a "definite, if subtle, shift in the direction of the Board's efforts" contributed to the rather cool reception of the studies. Indeed, Weldon Powell, chairman of the Board, signaled the shift in attitude back to the traditional practice-based approach. In August, 1960, Powell (January, 1961), said:

Accounting principles, if they are to be generally accepted, must be practically applicable. The accumulated experience of the responsible elements in the business community cannot be ignored....This suggests that one of the first steps in an accounting research project should be to study prevailing practice—to find out what principles are actually being applied and what procedures are actually being followed in everyday life. (p. 28)

When Moonitz resigned in 1963, Grady accepted the position of director of the Research Division. Grady (November, 1963) stated that he took the position as director of

Slocum and King: Paul F. Grady: contributions in the development of accounting principles research on a temporary basis until a permanent director could be found. In June, 1963, the APB approved a research project to identify and codify accounting principles which have general acceptance. He later took great care to point out that the Board approved the project "without dissent" and in accord with recommendations of the project advisory committees of the postulates and principles studies and with full endorsement of Maurice Moonitz who was director of research. Thus, he said that no foundation existed for rumors of conflict between the new and previous research efforts, and any distinctions relate to immediate versus long-range efforts with parallel objectives.

Grady and Alvin Jennings, now chairman of the APB, appointed a new accounting research project advisory committee for the "Research Study to Inventory Generally Accepted Accounting Principles and Practices for Business Enterprises." Carman Blough, chairman, Andrew Barr, Weldon Powell, and Leonard Spacek were among the 14 members of the project committee. Grady's article, "The Quest for Accounting Principles," was used as the basis for the project. ("Project Advisory Committee on Accepted Accounting Principles," October, 1963)

Contributions as Director of Research

Grady, as the director of research, had to deal with a number of issues in addition to the development of the Inventory. He was responsible for the initiation of other research projects and assignment of researchers. Grady enlisted the aid of several large accounting firms in order to accelerate the research program. Many of the new projects implemented during his tenure involved practitioners rather than academic researchers. He also became directly involved with the question of the authority of the Board. Grady clearly stated, when accepting the position as director of research, that he would oppose any action that would lead to uniformity in accounting principles by

granting complete authority to the opinions of the Board. (Slocum and King, 1993)

The Inventory

Grady immediately began work on the inventory of accounting principles to quickly rectify the perceived deficiencies of ARS No. 3 in establishing a framework for accounting principles. He considered the project to establish generally accepted accounting principles to be largely a process of identifying principles or practices on which there was general agreement and developing a useful classification of these principles. This approach had been established in the article, "Quest for Accounting Principles," published in May, 1962, and it was utilized in the preparation of ARS No. 7. Grady stated that the project mission was to: (1) identify concepts, (2) establish a list of currently accepted accounting principles, (3) present the opinions of all authoritative bodies, and (4) supply explanations and definitions.

Grady referred to the report of the special committee on research programs in an attempt to define the scope of the study and admitted that his presentation of concepts was influenced by his personal views. The following sources served to determine whether an accounting practice had substantial authoritative support: (1) practices commonly found in business, (2) requirements and views of the stock exchanges, (3) regulatory commissions' uniform system of accounts and account rulings, (4) regulations and opinions of the SEC, (5) opinions of practicing and academic CPAs, and (6) published opinions of the AAA and the Institute. The format used in the Inventory was designed to be accessible to accountants who needed information on a specific topic and provided the only comprehensive discussion of accounting principles for which authoritative support existed.

The Institute published the Inventory in 1965, and it proved to be a successful publication. Grady encouraged the Board to

maintain and update the Inventory. George C. Watt, a partner in Price Waterhouse & Co., did update the Inventory for all subsequent APB opinions. An updated version was used in an international study to outline the major differences in accounting principles between the United States and twenty four other countries. (Grady, January, 1972) The profession's reaction to ARS No. 7 was much more positive than it had been for ARS Nos. 1 and 3. Carey (1970) stated that it "served not only as a convenient reference to analysts of financial statements but as a basis for examination of areas in which diversity of practice existed and which therefore needed the attentions of the APB." (p. 142)

The publication of the Inventory concluded Grady's direct involvement with the Research Division. He had achieved his goal related to the establishing of generally accepted accounting principles in what he considered a reasonably simple and straightforward manner. Grady's Inventory provided stability at a crucial, tumultuous point in time for the profession. Its pragmatic, practice-oriented approach calmed the fears of many practitioners regarding the normative approach utilized in ARS No. 3. ARS No. 7 strengthened the profession by codifying generally accepted accounting principles. It served to strengthen accounting from society's perspective by defining a body of knowledge upon which the profession can base its claim to expertise.

Conclusion

Paul F. Grady has been acclaimed as a practitioner, researcher, scholar, and public servant. (Previts, 1986) His background, as a practitioner in two of the largest and most respected accounting firms, enabled him to discern the major problem areas confronting the profession. Grady's work in public accounting greatly influenced his professional activities, and he is one of the few leaders of the time who remained active both in practice and in professional service.

Grady played an important role in the establishment of the Accounting Principles Board and the Research Division of the

Institute. Paul Grady is well known for his development of ARS No. 7, the *Inventory of Generally Accepted Accounting Principles for Business Enterprises*, which was developed on the premise that the profession needed a codification of accounting principles and was intended to serve as a starting point by providing a comprehensive summary of the then accepted accounting principles. The Inventory was not revolutionary in nature; however, it documented the evolution of accountancy's basic practices. The Inventory closely followed the school of thought that principles should not be uniform. Instead flexibility was identified as the appropriate philosophy for principle utilization. Grady documented practice, provided a basic framework in which generally accepted accounting principles could be developed, arranged the principles in a useful format, and was concise in his presentation while fully covering the subject matter.

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