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# The Role of Research in the Development of Accounting Theory

Virginia R. Huntington, CPA

During the past several years accountants, through the AICPA, have implemented a research program designed to examine the basic nature and objectives of accounting as an expression of economic activity. The program, as developed by the profession, has provided a central vehicle for the analysis of accounting thought and for the construction of an accounting principles inventory. A recently released principles research study constitutes an unofficial summary of accounting concepts and principles prepared for the consideration of the Accounting Principles Board. It should provide some useful guidelines for a further refinement of principles within the framework of underlying business objectives and the basic concepts of accounting.

In order to understand some of the ramifications of the research effort of the Institute, one should review the history of its development. In 1957, Alvin R. Jennings, the then newly-installed president of the AICPA, "called for the establishment of an expanded and independent Institute research program . . ."<sup>1</sup> He proposed that the research effort should "re-examine the basic assumptions of accounting . . . develop authoritative statements to guide accountants, and . . . aid in improving understanding of financial statements by those who relied upon them."<sup>2</sup> As a result of his suggestions, the Accounting Principles Board was established to assume the responsibilities of the Institute's Committee on Accounting Procedure. It was anticipated that the previous "case-by-case" approach of the Committee would be replaced by a conceptual approach on the part of the Board, in order to get at the foundations of accounting. Mr. Jennings appointed a special committee on research program. The committee's report of December, 1958 became the basis of the Charter Rules of the Accounting Principles Board.

The special committee recommended<sup>3</sup> that the Accounting Principles Board be designated as "the sole group within the Institute having authority to make or authorize public pronouncements on accounting principles." The committee stated further that the Board ordinarily would not act upon any matter "until it has been thoroughly studied by a competent independent investigator from the research

staff, who is advised in carrying out the research study by the Director of Accounting Research . . ."

In August, 1964 Mr. Jennings, as Chairman of the Accounting Principles Board, reported on the status of the acceptance of the Board's opinions.<sup>4</sup> In December, 1962 the Board had issued its Opinion No. 2 on the subject of the accounting treatment of the Investment Credit and had met serious challenges from a conflicting opinion issued by the S.E.C. and from public statements made by several members of the accounting profession. In April, 1963 the Board voted to request the Executive Committee of the Council of the Institute to implement the revision of the Institute's standards of reporting "so that they would be related to pronouncements of the Board."<sup>5</sup> Recommendations presented to Council were (1) that members, in reporting on financial statements should direct attention to any variation from principles which the Board had approved and (2) that the auditing standards of the Code of Professional Ethics be similarly amended.<sup>6</sup>

In 1964 the Spring Council meeting of the Institute became the focal point of an extended professional debate. Finally, the Council resolved that it was the sense of the meeting that reports of members "should disclose material departure from Opinions of the Accounting Principles Board and that the President is hereby authorized to appoint a special committee to recommend to Council appropriate methods of implementing the substance of this resolution.

Following the resolution of Council, AICPA President Clifford V. Heimbacher announced his appointment of a committee on Accounting Principles Board opinions, to operate under the chairmanship of William W. Wernitz, a former chief accountant of the S.E.C. and the last chairman of the discontinued Committee on Accounting Procedure. Other members of the committee appointed were: Albert J. Bows, Chairman of the AICPA Committee on Auditing Procedure; Paul Grady, retiring AICPA Director of Research; John R. Ring, Chairman of the Institute's Committee on Professional Ethics; J. S. Seidman, a former President of the Institute and the first Chairman of the Institute's

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Long-Range Objectives Committee (organized in 1957); Maurice H. Stans, a former President of the Institute; and Glenn A. Welsch, President of the American Accounting Association. The committee was asked to report at the Fall Meeting of Council in Miami Beach in October.

The report of the special committee, submitted to the Fall Council Meeting, was adopted with two amendments, the first calling for further study before voting on whether to make the disclosure provisions enforceable under the Institute's Code of Professional Ethics, and the second providing that disclosures of departures from Board opinions could be made by management in footnotes to the financial statements rather than in the auditor's report. The committee stated in part<sup>8</sup>

- (1) Generally accepted accounting principles are those principles which have substantial authoritative support.
- (2) Opinions of the Accounting Principles Board constitute substantial authoritative support.
- (3) Substantial authoritative support can exist for accounting principles that differ from Opinions of the Accounting Principles Board.
- (4) No distinction should be made between the Bulletins issued by the former committee on accounting procedure on matters of accounting principles and the Opinions of the Accounting Principles Board. Accordingly, references in this report to the Opinions of the Accounting Principles Board also apply to the Accounting Research Bulletins.

The Committee stated further<sup>9</sup> that the reporting member must decide whether an accounting principle has been employed which does not coincide with APB opinion; if it does not he must decide whether there is other "substantial authoritative support." If not, he must qualify or withhold an opinion, or issue an adverse opinion, as is appropriate. If he concludes that there is other authoritative support, he may issue an unqualified opinion but he must disclose the departure from APB opinion in his report or see that the disclosure is presented by management in a footnote to the financial statements. These provisions are effective for fiscal periods that begin after December 31, 1965. The Accounting Principles Board will review all existing APB opinions in the light of these provisions to determine whether any of the five opinions issued to date should be amended or withdrawn. Accounting Research Bulletins will be subject to the same type of review.

The rest of the story of recent developments

in the new research effort first inaugurated by the AICPA in 1958 consists of a report on the activities of the Research Director and his staff. Mr. Reed K. Storey, former Assistant Director, succeeded Mr. Paul Grady as Director on September 1. Mr. Storey has written a very interesting historical summary of AICPA research and of the highlights of research activities conducted by individuals and by the American Accounting Association, integrating the more significant accomplishments into a pattern of growth and development of accounting thought. Reading this publication is well worth the time of any accountant. It is entitled *The Search For Accounting Principles, Today's Problems in Perspective*, published by the AICPA.

The Research Staff of the Institute has issued seven research studies, dealing with basic postulates, cash flow, broad principles, leases, business combinations, price-level problems, and an inventory of generally accepted accounting principles for business enterprises. Other studies are in formative stages. Some of the first six studies (notably the third) have been criticized as being too far removed from current practice, stressing in terms of the authors' views "what should be" rather than "what is." However, most accountants agree that all of the research studies are significant documents and that all have contributed to the development of a foundation for the construction of an inventory of principles. The studies have not received official endorsement from the APB. Presumably the Board will use the studies as reference material in developing its pronouncements of opinion. Initially, the Board has issued its opinions in specific problem areas created by the depreciation guidelines of the Internal Revenue Service and by the investment credit of the tax law, by the trend toward the presentation of "cash-flow" per share in published financial statements, and by controversy over the appropriate disclosure of long-term lease obligations in financial statements.

The 1964-1965 AICPA President, Thomas D. Flynn, has called on business leaders, investment analysts, and others to support the APB effort. Following are some excerpts from his remarks:<sup>10</sup>

"... top management, including financial executives, has a primary interest and responsibility . . . in the ground rules which govern the preparation and presentation of financial statements. . . ."

"With an increased participation by, and cooperation between, all groups in our society who have a strong interest in the continued development of accounting principles, I am confident

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## Role of Research

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that we can make the calm, steady, and persistent progress we all want.

“. . . you should inquire deeply into the reasoning which supports the acceptance or rejection of a given accounting principle. . . .

“I am personally determined to do everything I can to see that the American investor has access to all the information needed for intelligent decisions.”

From all appearances, the role of research in the development of accounting theory is assuming a new dimension. The complementary efforts of the APB and of the Director of Research of the AICPA are beginning to show the promise of a leadership desperately needed if the profession is to achieve a greater uniformity in the understanding and application of accounting principles. Investors and others who rely on published financial statements for information upon which to base investment and other financial decisions will be the prime beneficiaries of the research program. The preface of the recently published principles study cites the desire of the research staff and of Mr. Paul Grady, Director during most of its formulation, to summarize the significant research accomplishments of predecessor committees and individuals, and to “look forward to future progress.”<sup>11</sup> Such progress may be anticipated if the business community supports the Accounting Principles Board with constructive criticism in the early stages of the drafting of its opinions and follows the disclosure resolution of the Council of the American Institute when Opinions of the Accounting Principles Board are not followed in the preparation of financial statements.

### Footnotes

<sup>1</sup>Reed K. Storey, *The Search for Accounting Principles* (New York: The American Institute of Certified Public Accountants, 1964), p. 7.

<sup>2</sup>*Idem.*

<sup>3</sup>*Ibid.*, p. 55.

<sup>4</sup>Alvin R. Jennings, “Opinions of the Accounting Principles Board,” *The Journal of Accountancy*, August, 1964, pp. 27-33.

<sup>5</sup>*Ibid.*, p. 27.

<sup>6</sup>*Ibid.*, p. 28.

<sup>7</sup>*Ibid.*, p. 29.

<sup>8</sup>News Report, *The Journal of Accountancy*, November, 1964, pp. 11-12.

<sup>9</sup>*Ibid.*, p. 12.

<sup>10</sup>Editorial comment and excerpts from speeches by Thomas D. Flynn, *The February, 1965 CPA* (New York: The American Institute of Certified Public Accountants), pp. 2-3.

<sup>11</sup>Paul Grady, *Inventory of Generally Accepted Accounting Principles for Business Enterprises* (New York: The American Institute of Certified Public Accountants, 1965), p. viii.

## Impressions

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modern shops and escalators have been built where bomb craters must have gaped not so very long ago. In spite of their troubles, however, the Viennese can still enjoy a joke, and give a hearty welcome to visitors from abroad.

Vienna lies within the eastern tip of Austria, very near the frontiers with Hungary and Czechoslovakia, and it was strange for us to see the signposts pointing to places beyond the Iron Curtain. Travel between West and East seems to be quite easy, and Frau Leifer had in fact spent a holiday weekend in Hungary just before the Congress.

Like most visitors to Vienna, we made a point of seeing the famous Blue Danube. This great river was doubtless blue and beautiful at the time when Johann Strauss wrote his immortal waltzes, but now the Danube is a busy grey waterway, carrying barges and industrial traffic, as well as pleasure steamers. We crossed the river by a modern bridge to visit the International Garden Show, which was made recently on what was formerly waste ground to the northeast of the city. A huge new tower in the grounds is crowned by a revolving restaurant, which gives its patrons a splendid view of Vienna and the surrounding country, and of the Danube winding on its way towards Hungary.

Another afternoon we were privileged to attend a special performance of the Spanish Riding School, which was conveniently near the Congress Centre, in another part of the vast Hofburg. The Riding School is the oldest of its kind in the world, having been founded in 1565. The splendid Riding Hall, erected between 1729 and 1735, looks like a ballroom, apart from the thickly sanded floor. The perfectly trained white horses are descended from Spanish stock, originally brought to Vienna for the Imperial stud in 1580. They seemed proud to show their paces to the spectators in the pillared galleries.

A banquet and ball in the halls of the Hofburg on the final evening made a fitting climax to the Congress. Most of the guests at the long, decorated tables wore full evening dress. The formidable menu included a Danube Fish dish, and rather to our surprise “filet de boeuf a l'anglaise”—roast beef. The sweet was a typically Viennese Apfel Strudel, and there was a profusion of every kind of drink, from beer to champagne. In the interval between banquet and ball, we had the pleasure of watching a delightful ballet, by dancers of the State Opera. Thereafter the musicians took over, and a gay night's dancing—waltz and polka, cha-cha and twist—brought a hectic week to a happy close.