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Manuscript 2711

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## Accounting Principles, Circa 1776

Philip E. Meyer

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# Accounting Principles, Circa 1776

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**In line with the Bicentennial Celebration the author reveals the recently discovered minutes of an early discussion of accounting principles. The article is adapted from an article appearing in the January-February 1975 issue of the Massachusetts CPA Review and is reprinted with the permission of that journal.**



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A recent discovery of documents, yet to be authenticated but tentatively known as the Charles River Scrolls, indicates that while the founding fathers may have been concerned with life, liberty, and pursuit of happiness, another group of founders may have addressed themselves to the matter of accounting principles. It seems that subsequent to the drafting of a certain well-known Declaration, there was a debate regarding the basic concepts and conventions of accounting. At the risk of being sacrilegious, excerpts from the minutes of one such historic session are presented below as a public service to readers whose interest in accounting principles is usually restricted to contemporary developments in accounting theory and practice.

Elizabeth: "As far as inventory is concerned, I say we should allow both FIFO and LIFO."

Ann: "But by sanctioning LIFO, we would be permitting tea leaves left over from the Boston Tea Party to be carried in twentieth century balance sheets at 1773 prices!"

Catherine: "Of course we would. We simply justify it on grounds of conservatism. In fact we'll justify the lower-of-cost-or-market rule on the basis of conservatism as well."

Ann: "You're a fine one to advocate conservatism; we all thought you were a real authentic liberal."

Margaret: "Speaking of the Tea Party, should we regard the loss of tea as being an ordinary or extraordinary loss?"

Elizabeth: "And whatever way you go, will it be disclosed on a net of tax basis?"

Catherine: "Now that you mention such unheard of things as taxes, why not also require footnote disclosure of the social cost effect of polluting Boston harbor?"

Margaret: "What's this I hear about footnotes? Did we attach any footnotes to the Declaration of Independence? No siree; anything worth mentioning we include in the body of the statement."

Mary: "Back to the central point, all this chatter about FIFO and LIFO, you know, assumes that the cost basis of accounting will remain supreme. Are we truly prepared to burden future generations with such a convention?"

Elizabeth: "I happen to think the historical cost basis is very important because if, for no other reason, the word 'historical' will cause accountants forever and ever to be reminded of the importance of us, their historical roots."

Ann: "Why would anyone not be content with the cost basis anyway?"

Catherine: "It is possible that in future generations, the current values of assets might differ significantly from their original cost."

Margaret: "We could always introduce depreciation procedures to take care of that. Take, for instance, Faneuil Hall, which dates back some thirty odd years to 1742. You could estimate a useful economic life of 50 or 60 years and thereby reduce its net carrying value on subsequent balance sheets."

Catherine: "But suppose your estimate is wrong. Just suppose Faneuil Hall, or even the State House which was built back in 1713, were to survive their estimated useful lives, and even be used in the very, very distant future such as the nineteenth or twentieth centuries, what happens then to your depreciation accounting?"

Margaret: "We could call such a situation a change in accounting estimate and concern ourselves only with its prospective effect by depreciating lesser amounts once we determine its life is going to be longer than our original expectations."

Ann: "Not to mention that depreciation would apply only to resources experiencing obsolescence or physical deterioration.

What about the decline in value of natural resources such as a well-known cherry tree? Are any of us prepared to play with a hot potato like depletion accounting?"

Mary: "Forget the isolated cases of depreciable and depletable assets. What relevance does historical cost have in a period of inflation?"

Elizabeth: "No, Mary, I think we can assume away inflation on the basis of being immaterial. This is the New World; there's no way too many dollars would ever be chasing too few goods. We've got all the natural resources we need for centuries and centuries."

Catherine: "Since we're talking about rules that would be applied many years down the road, let me raise this question. I've got some plans for us to go out and annex some property which would become known as Louisiana. How would such a combination be accounted for? And based on your answer, recognize that it would be referred to by all future accountants as either the Louisiana Purchase or the Louisiana Pooling of Interests!"

Ann: "And would the accounting be affected by whether the acquired entity becomes a state or whether it remains a self-contained territory?"

Margaret: "I think we should adopt a method whereby the investor's equity in changes in the investee's net worth be accounted for whether or not there is consolidation. In fact, such an approach might just be called the equity method."

Mary: "But suppose such affiliated entities are half-way around the world where they have different currency and an unusual political environment. We would have to translate the financial data into their dollar equivalent. It would

be very difficult to do this if there were to be fluctuations in currency exchange rates, not to mention major devaluations."

Elizabeth: "Are these problems any different from those resulting from arm's length transactions with foreign enterprises like when an American owes or is owed money payable in foreign currency?"

Catherine: "Not to change the subject ladies but consider for a moment whether persons practicing as accountants should be certified."

Ann: "By whom?"

Catherine: "Perhaps by the state, perhaps by a panel of peers."

Elizabeth: "On what basis would such licensing be granted?"

Catherine: "How about a combination of educational background, field experience, and a rigorous written examination?"

Elizabeth: "If we go about this in the right way, accountants might even be considered to be members of a profession."

Catherine: "Just like doctors and lawyers."

Ann: "They might even be entitled to a confidential relationship with clients which could become meaningful in a courtroom."

Catherine: "Speaking of courts, wouldn't they also be susceptible to malpractice suits?"

Ann: "In theory you're absolutely right, but in practice it'll never happen. Believe me, I have prophetic vision. . . ."