Research Article

Stephen A. Zeff*

Some Historical Reflections on “Have Academics and the Standard Setters Traded Places?”

Abstract: This is an attempt, albeit brief, to provide some historical observations on the hypothesis in Jonathan Glover’s article that U.S. academics and standard setters have at some point swapped postures with respect to oughtness and descriptive generalization – that is, as between normativism and positivism.

Keywords: accounting regulation, accounting theory, accounting academics, standard setting

*Corresponding author: Stephen A. Zeff, Rice University, E-mail: sazeff@rice.edu

Table of contents

- 1 Academics
- 2 The standard setters and the influence of the Securities and Exchange Commission
- 3 Conclusion
- References

Symposium papers in issue 1 (2014) “Have Academic Accountants and Financial Accounting Standard Setters Traded Places?”

- 1 “Have Academic Accountants and Financial Accounting Standard Setters Traded Places?” by Jonathan Glover
DOI 10.1515/ael-2014-0001
- 2 ““Trading Places”: A UK (and IFRS) Comment” by Richard Macve
DOI 10.1515/ael-2013-0011
- 3 “Some Historical Reflections on “Have Academics and the Standard Setters Traded Places?”” by Stephen A. Zeff
DOI 10.1515/ael-2013-0028

A study of history does not usually make it easy to assign themes to neat chronological compartments. My comments in this symposium contribute a historical reflection on Jonathan Glover’s hypothesis that, perhaps around 1973 – but allowing for a margin of 10 years on either side – US financial accounting academics switched from being normative to positive and the US standard setters switched from being positive to normative, thereby trading

places. It's an interesting and provocative suggestion. As will be shown, standard setters did largely follow this pattern (albeit with active oversight by the regulator), but the direction taken by the committees of the American Accounting Association since then has been more difficult to characterize.

I adopt Jonathan's definition of positive and normative, as follows: "By a positive orientation, I mean observed practice serves as the starting point we try to understand, abstract from, and generalize. By a normative orientation, I mean an attempt to prescribe what practice should be." In regard to advice-giving by committees of academics, I interpret "normative" as referring to the committees' conveying their members' views, or opinions, about proper practice. "Positive" in this context means the committees' synthesizing the findings of empirical research. In terms of the work of a standard setter – because all of its utterances are *per se* prescriptions about what practice should be – I interpret "normative" as signifying the endeavor to change practice, to improve practice, and not just to codify or rationalize existing practice. From the 1940s to the 1960s, the Securities and Exchange Commission (SEC), as will be seen below, exhorted the standard setter to "narrow the areas of difference," that is, to remove options. I therefore interpret "normative" to include also the standard setter's response to this insistent charge from the SEC.

When discussing normative research in the academic accounting literature, I confine this set to what I have called normative policy prescription, or traditional normative research, as distinguished from information economics and other mathematical model-building research (Dyckman & Zeff, 1984, pp. 227–229).

This paper is divided into three sections: academics, the standard setters operating under the influence of the Securities and Exchange Commission (SEC), and conclusion. Especially during the Accounting Principles Board (APB) period, from 1959 to 1973, one cannot discuss the APB without also assaying the influential role of the SEC's accounting staff. The Securities Exchange Act of 1934 delegated to the SEC the authority to determine the content of the financial statements for companies subject to its jurisdiction. But since the late 1930s, the SEC has regularly looked to the private sector for leadership in recommending proper accounting practice, which has been known since the early 1970s as the setting of accounting standards. Yet, the SEC has always made it clear that it is the final arbiter of proper practice.

1 Academics

As Jonathan's paper discusses how academics and standard setters have traded places, I think it makes sense to examine the changing role of academics in relation to the way they have undertaken to advise the standard setters. Other

roles played by academics in giving advice to the FASB or the SEC – for example, serving as academic fellows – do not lead to a published record of the kind of advice they gave, whether mostly synthesizing research findings or conveying their opinion on what constitutes best practice.

I will focus here on the institutional advice-giving by the American Accounting Association (AAA). In 1936, mentioned by Jonathan in his paper, the AAA began issuing a series of statements on accounting principles, drafted either by its executive committee or by a committee chosen specifically for this purpose. The “principles” statements were issued in 1936, 1941, 1948, and 1957. Eight supplements on specific topics were issued between 1950 and 1954.¹ These were all normative, arguing for proper accounting practice, and it was hoped that they would influence the standard-setting process. In 1940, the AAA published the hugely influential monograph, *An Introduction to Corporate Accounting Standards*, by W. A. Paton and A. C. Littleton (1940), which elaborated on the 1936 statement and was itself entirely normative. Jonathan refers to the AAA’s *A Statement of Basic Accounting Theory (ASOBAT)*, a normative document prepared by the committee and published in 1966.

It is instructive to compare this earlier line of AAA statements on accounting principles with the next such statement, issued in 1977. This is when the AAA published *Statement on Accounting Theory and Theory Acceptance* (Committee on Concepts and Standards, 1977), which was also a report by a special committee of accounting academics, which was charged with writing a statement “that would provide the same type of survey and distillation of current thinking on accounting theory” as *ASOBAT* had in 1966 (p. ix). Instead of being normative, its report comprehensively reviewed and examined the theory literature, in a positivist vein, and concluded that there was no one theoretical approach which had risen to a position of prominence relative to the others. Until this point, Jonathan’s thesis that, after the early 1970s, the academics had changed their posture from normative to positive can be supported.

The next phase of the AAA’s academic advice-giving to the standard setter began in the 1990s, when its Financial Accounting Standards Committee wrote reports, all published in *Accounting Horizons*, on exposure drafts and other tentative documents issued for the most part by the FASB. Some of the exposure drafts on which the committee wrote reports were issued by the International Accounting Standards Board or by the SEC. From 1993 to 1996, the committee published 18 such reports, and they were all normative. From

¹ All of these statements were reproduced in 1957 by the AAA in its 64-page booklet, *Accounting and Reporting Standards for Corporate Financial Statements and Preceding Statements and Supplements*. All of them were also published in *The Accounting Review* at the time of issuance.

1997 to 1999, the committee issued nine more such reports, of which five were normative and four were positive. Thus, the committee's move toward issuing positive reports had begun, wherein it confined its role to reviewing the findings in the research literature so as to throw useful light on the issues being raised by the standard setter. From 2000 to 2004, all ten such reports were positivist. Since then, the 18 committee reports published between 2005 and 2012 have reflected a mix of normative and positive approaches, depending, apparently, on the composition of the committee, or perhaps on the intention of the chair or of the member designated as the primary author. I understand that some AAA presidents, when constituting the committee, may have preferred either a normative or a positive approach, and chose the members and gave the committee its charge correspondingly. Overall, then, the AAA committee reports from 1993 onward were normative, then positive, and then a mixture of both. This trend does not do much to confirm Jonathan's thesis.

In addition, a committee of the AAA's Financial Accounting and Reporting Section published four comments on drafts – one in 2008, one in 2009, and two in 2010. One was normative and three were positivist. But, this is a very small sample.

One should also comment on the general trend in the character of published accounting research over this span of time. Prior to the 1970s, normative research was predominant in US journals and in books, but beginning in the 1960s, mainly fueled by the Ford Foundation and Carnegie Corporation reports of 1959 on business education as well as the follow-on Ford Foundation financial support, and the development of high-speed computers and rich databases, accounting research shifted strongly toward empirical work, and normative research correspondingly received much less attention in the journals (see Dyckman & Zeff, 1984). By the 1980s, there was very little normative research being published in the premier US accounting research journals.

2 The standard setters and the influence of the Securities and Exchange Commission

Prior to 1973, when the full-time FASB began operations, the SEC played a very large role in the deliberations of the Committee on Accounting Procedure (CAP) from 1939 to 1959 and the APB from 1959 to 1973, both of which were part-time committees of the American Institute of (Certified Public) Accountants

(AICPA). Indicative of this close monitoring role of the APB by the SEC's accounting staff was the following passage that appeared in the SEC's 1969 annual report:

In furtherance of the policy of cooperation between professional organizations and the Commission, the [APB] submits drafts of [its research] studies, opinions and statements to the Chief Accountant for review and comment prior to publication, and representatives of the Board confer with him on projects in progress or under consideration. (p. 57)

It is clear from a reading of the minutes of the APB meetings that SEC Chief Accountant Andrew Barr was regularly consulted during the development of projects. One Big Eight firm partner who regularly attended APB meetings has confirmed that “the Board really didn't do very much without talking to Andy Barr.”²

Three of the early SEC chief accountants from (William W. Wernitz, Earle C. King, and Barr) beat back a series of attempts by the CAP and the APB from the 1940s to the 1960s to recommend upward revaluations of tangible fixed assets and general price-level accounting (Zeff, 2007a). Thus, in respect of just these facets of financial reporting, the standard setter sought to have an impact on practice but was “trumped” by the SEC. On some other subjects taken up in the 1940s and early 1950s, the CAP did little more than codify practice (and often allowed optional practices), or if it did attempt to change practice, the SEC sometimes rebuffed the attempt (Storey, 1964, pp. 48–51; Zeff, 1972, pp. 150–160).

In the latter 1950s, the CAP attempted to be more normative, when it issued *Accounting Research Bulletins* 44 Revised, 47, and 48 on income tax allocation, pensions, and business combinations, respectively, although these recommendations represented only modest changes in practice. One of the factors precipitating the CAP's initiatives to influence accounting practice, rather than just codify it, was the frequent speeches by Leonard Spacek, the outspoken managing partner of Arthur Andersen & Co., who criticized the CAP for allowing so much flexibility in accounting practice (Zeff, 1972, pp. 169–170). Spacek's aggressive stance had much to do with the AICPA's decision in 1959 to replace the CAP with the APB (Zeff, 2001).

In 1962, the recently established APB approved, by the narrowest majority, only one method of accounting for the investment tax credit, but pressure from the Treasury Department led the SEC to allow two methods, which was an

² Interview with Arthur R. Wyatt, July 14, 2011.

embarrassing setback for the APB (Moonitz, 1966). Until the middle of the 1960s, the APB had been having difficulty securing agreement among its members to “narrow the areas of difference in accounting practice,” which had been the SEC’s charge to the CAP and then to the APB. There was a philosophical difference among several of the Big Eight accounting firms over how much flexibility should be allowed in its *Opinions* (Zeff, 2001, p. 149). SEC Chairman Manuel F. Cohen (chairman from 1964 to 1969) had been criticizing the APB in speeches for its lack of activism in narrowing the areas of difference in practice (Zeff, 1972, pp. 189, 192), and Cohen actually had the SEC issue an *Accounting Series Release (ASR)* in 1965 to prescribe proper accounting practice in an area when the APB found itself unable to do so itself (Zeff, 2007b). Under this pressure from the SEC, the APB began to issue a series of important normative *Opinions* between 1967 and 1971 that changed practice: *Opinion* 11, accounting for income taxes; 15, earnings per share; 16, business combinations; 17, intangible assets; 18, the equity method of accounting for investments in common stock; 19, reporting changes in financial position (i.e., fund statements); 20, accounting changes; and 21, interest on receivables and payables (i.e., requiring the use of present values) (Zeff, 1972, pp. 200–218). Some of these, such as the required publication of a funds statement and the required use of present values for long-term receivables and payables, represented major changes in practice. Clearly, the APB was steadfastly normative during its latter years, but under the heavy hand of the SEC. Only intense political lobbying in 1971–1972 prevented the Board from progressing toward the development of *Opinions* that might have changed practice on accounting for the investment tax credit, accounting for marketable securities, oil and gas accounting, and accounting for leases.

In 1972, John C. (Sandy) Burton became the SEC chief accountant, and he aggressively pushed for expanded disclosures, including lessee disclosures (ASR 147, issued in 1973), inventory profits disclosure (ASR 151, issued in 1974), and replacement cost accounting supplementary disclosure (ASR 190, issued in 1976).

The FASB was formed in 1973 as an independent body (instead of another committee of the AICPA), and it was therefore believed to be free of the influence of the major accounting firms, which always were represented on the CAP and the APB. The FASB from 1973 onward generally adopted a normative stance, but at times it has been forced to compromise because of political lobbying (see Zeff, 2012). Thus, I think the record largely supports Jonathan about the normativism of the standard setter since the latter part of the 1960s. But one must interject that the standard setter has not been free of influence from the SEC or from powerful interest groups.

The SEC continued to exert influence on the FASB, although it was not as intrusive as it had been in the processes of the CAP and the APB. Two illustrations of its influence were the following. In 1991, SEC Chairman Richard C. Breeden effectively forced the FASB to place accounting for marketable securities on its agenda, else he said that the SEC would issue a release of its own on the subject. Breeden wanted to see a requirement for mark-to-market accounting (Johnson & Swieringa, 1996, p. 158). This led to SFAS 115, which was a compromise solution driven by intense lobbying from the banking industry, yet it changed accounting practice (Zeff, 2012, pp. 248–249). In 1996, the SEC chief accountant, speaking at an open meeting of the FASB's Financial Accounting Standards Advisory Council, complained that “pooling of interests” questions from companies were consuming 40 to 50 percent of his staff's time, and he said that he would like to see the FASB issue a standard on the matter. The FASB was already contemplating a project on poolings, but the urging from the chief accountant pushed it over the line, and business combinations promptly appeared on the FASB's agenda.³

3 Conclusion

As to academics, their AAA committees were uniformly normative until the end of the 1960s and then became positivist for a major report issued in 1977. But they have veered between normativist and positivist in their many reports on exposure drafts from 1993 to 2012. So, a generalization about their behavior is not easily made.

As to the standard setters, the APB issued important normative recommendations between 1967 and the early 1970s, and it would have issued even more had political lobbying not intervened. Since it began operations in 1973, the FASB has been normative even in the face of political lobbying.

The standard setter, as prodded by the SEC, indeed turned normativist beginning in the late 1960s, as Jonathan argues, although it is interesting to recall the series of attempts by the CAP and the APB from the 1940s to the 1960s to adopt normative positions in favor of the upward revaluation of tangible fixed assets and general price-level accounting which were defeated by the intervention of the SEC.

3 Interview with James J. Leisenring, July 25, 2012. See Zeff (2002, pp. 50–51).

References

- American Accounting Association. (1966). *A statement of basic accounting theory (ASOBAT)*. Sarasota, FL: American Accounting Association.
- American Accounting Association. (1957). *Accounting and reporting standards for corporate financial statements and preceding statements and supplements*. Madison, WI: American Accounting Association.
- Committee on Concepts and Standards for External Financial Reports. (1977). *Statement on accounting theory and theory acceptance*. Sarasota, FL: American Accounting Association.
- Dyckman, T. R., & Zeff, S. A. (1984). Two decades of the Journal of Accounting Research. *Journal of Accounting Research*, 22(1), 225–297.
- Johnson, L. T., & Swieringa, R. J. (1996). Anatomy of an agenda decision: Statement no. 115. *Accounting Horizons*, 10(2), 149–179.
- Moonitz, M. (1966). Some reflections on the investment credit experience. *Journal of Accounting Research*, 4(1), 47–61.
- Paton, W. A., & Littleton, A. C. (1940). *An introduction to corporate accounting standards*. Chicago: American Accounting Association.
- Storey, R. K. (1964). *The search for accounting principles: Today's problems in perspective*. New York, NY: American Institute of Certified Public Accountants.
- Zeff, S. A. (1972). *Forging accounting principles in five countries: A history and an analysis of trends*. Champaign, IL: Stipes Publishing Company.
- Zeff, S. A. (2001). The work of the special committee on research program. *The Accounting Historians Journal*, 28(2), 141–186.
- Zeff, S. A. (2002). Political lobbying on proposed standards: A challenge to the IASB. *Accounting Horizons*, 16(1), 43–54.
- Zeff, S. A. (2007a). The SEC rules historical cost accounting: 1934 to the 1970s. *Accounting and Business Research, International Accounting Policy Forum* special issue, 49–62.
- Zeff, S. A. (2007b). The SEC preempts the Accounting Principles Board in 1965: The classification of the deferred tax credit relating to installment sales. *The Accounting Historians Journal*, 34(1), 1–23.
- Zeff, S. A. (2012). Political lobbying on accounting standards – US, UK and international experience. In C. Nobes & R. Parker (Eds.), *Comparative international accounting* (12th ed., pp. 233–263). Harlow, England: Pearson.
- 35th Annual Report of the Securities and Exchange Commission, for the Fiscal Year Ended June 30th, 1969*. (1969). Washington, DC: United States Government Printing Office.