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ACCOUNTING STANDARDS : BOON OR CURSE?

by
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February 13, 1979



[Introductory note: William T. Baxter is Professor-emeritus of Accounting, London School of Economics, and a Visiting Professor at Bernard M. Baruch College. He trained as an accountant in Edinburgh and is a member of the Institute of Chartered Accountants of Scotland. Thanks to a Harkness Fellowship, he did graduate study at the Wharton and Harvard Business Schools. Before going to the London School of Economics, he was a lecturer at the University of Edinburgh and professor at the University of Cape Town.

Some of Professor Baxter's articles have just been republished as *Collected Papers on Accounting*. Other books include one on John Hancock's business career, *The House of Hancock: Business in Boston, 1724-75*; also *Depreciation, and Accounting Values and Inflation*; with Professor Sidney Davidson of Chicago, he edits *Studies in Accounting*. He lectures mainly on accounting theory and especially its aspects that border on economics.]

It is fitting that a school should show gratitude to those who have built it, and I am glad to add my tribute to Professor Saxe. A series of lectures is a splendid way with which to acknowledge our debt. Your preceding lecturers have all been outstanding. I feel rather out-of-place -- though very honored -- to be added to the list.

Most of you, if asked "What is the biggest change in accounting during your lifetime?" would probably point to the emergence of "standards". These were almost unknown before World War II. Now they dominate the accountant's work. They already fill volumes; and fresh ones keep pouring forth with no sign of the stream drying up. They are to be found in many lands; and national standards are being topped up with EEC standards and international standards. They cover accountants, auditors, cost accountants, and probably other species that I do not know about: any accounting group that is not yet emitting standards must feel sadly behind the times, and will no doubt soon be adding its contribution.

We all welcomed standards when we first heard of them, and we all accept that they have great influence. They give us handy rules for our work. We believe that they raise the quality of accounts, make company reports more intelligible, and foster comparability; they dispel doubts, and -- we hope -- soon will bring harmony of principle. In a world made safe by enough standards, accounting will be plagued by few scandals, and our noisy defamers will have to hunt elsewhere for a quarry.

Individualism versus collective controls

In passing, we should perhaps dwell for a moment on a rather odd thing.

It is a safe bet that some 90% of accountants are not excessively fond of government. Their political philosophy holds that the state should interfere little in the affairs of good citizens, and that state controls soon reach a point at which they do more harm than good. Such men would scoff at the notion that, by entrusting difficult problems to political authority, we bring the millenium closer.

Yet these men are now happily erecting and submitting to an extra form of authority within their own profession. They hungrily demand more controls over their daily work, and do not doubt that the outcome will be good. Is this not a puzzling paradox?

Origins of Standards

It is perhaps worth our while to look back at the origin of standards. They grew from small and inconspicuous beginnings: I doubt if anyone said at the start: "what we accountants need is a set of official rules telling us how to handle every important aspect of our work".

The first milestone of note was the *Statement of Accounting Principles*, published by the American Institute in 1938. Though the Institute commended this book to members in a foreword, it was the work of three authors (Hatfield, Sanders, and Moore) who were not members but had been prompted by the Institute to carry out this task. Such an arrangement seemed excellent: the Institute encouraged research, but did not lend its authority to any of the findings.

Since then, the pronouncements have become more closely linked with the sponsoring bodies, and the latter have tended more and more to back the findings.

Thus the American Institute in 1939 charged its Committee on Accounting Procedure with the task of issuing research bulletins. The committee stated its aim as:

to consider specific topics, first of all in relation to the existing state of practice, and to recommend, whenever possible, one or more alternative procedures as being definitely superior to other procedures.

Bulletin Number 1 stressed the need for good accounts (particularly because of the growth of companies), and the consequent "demand for a larger degree of uniformity in accounting". It said that its rules would be subject to exception, but that "the burden of proof is upon the accountant clearly to bring out the exceptional procedure and the circumstances which render it necessary".

Just after World War II, the biggest group of British accountants, the Institute of Chartered Accountants in England and Wales, took a comparable step. It announced its venture in mild words that do not herald momentous change:

"The Council has requested the Taxation and Financial Relations Committee to consider and make recommendations to it on certain aspects of the accounts of companies and it is proposed from time to time to publish approved recommendations for the information of members."

The announcement continues with a clear denial of intent to make the new rules mandatory:

It is, of course, a matter for each individual member to consider his responsibility in regard to accounts presented by directors, but it is hoped that the recommendations to be made will be helpful to members in advising directors as to what is regarded as the best practice.(1)

Thus accounting bodies on both sides of the Atlantic drifted into the new system without clear ideas of where it would take them, and with few, if any, formal motions of consent by the members. A revolution took place with far less fuss than would be needed for a minor change in the bodies' constitutions.

Development of Standards

As you will remember, there have been several stages in the evolution of the committees that issue standards.

American developments

In America, the stages have been as follows:

1. Committee on Accounting Procedure

Accounting Research Bulletins (ARBs) were issued by the Committee on Accounting Procedure of the AICPA. The process started in 1939. By 1953, 42 ARBs had come out; in that year, they were consolidated into ARB 43. Only 8 more ARBs were issued during the remaining six years of the committee's life. (2)

The ARBs had a big impact. But the committee was subject to many pressures and distractions. Its members were part-time. Its staff were inadequate in numbers and kept changing. Its critics claimed that it did not rely enough on research, that it was the cat'spaw of the SEC, that it had no teeth, and that its bulletins were equivocal (e.g. the one on inventories authorized the use of three different methods).

2. Accounting Principles Board

Because of this dissatisfaction, the committee was scrapped in 1959 and replaced by the Accounting Principles Board. This had more money, and it engaged distinguished men to run a full-time research division. But otherwise it was much the same as its predecessor. It issued 31 "opinions" on a wide range of fundamental topics. Among other things, these tried to narrow areas of difference, and to settle such debatable issues as accounting for the oil and gas industry, research and development, and -- most controversial of all -- investment credits.

The APB too failed to placate the critics. They said that it was cumbersome in size, that it was dominated by the profession to the detriment of business, that is 20-odd part-time members met too seldom and did nothing till the research division sent up material. Its opinions aroused violent debate (that on investment credits inspired over a thousand letters of protest). Perhaps the hostility to them was a sign that they were likely to be effective: company managers preferred "flexibility" to clear-cut measures.

Dissatisfaction with the APB led to the setting up of yet another group:

3. The Financial Accounting Standards Board (1973)

This is composed of seven full-time members, from widely-separated backgrounds. It is generously financed, has a large and able staff, and is independent of the AICPA. It is punctilious about public hearings and first publishing its views as exposure drafts; its final statements are no longer "bulletins" or "opinions", but "standards". We must wait to see how much better this body functions than its predecessors; at least, its organization avoids many of their defects.

British developments

In Britain, the story has been rather different, in part because the profession is split into five major bodies, and has flatly rejected plans for unity. As I said above, the English Institute started the issue of "recommendations"; it continued the process till 1969. Then the other four bodies decided to sail in the same boat; a joint-committee of all (the Consultative Committee of Accounting Bodies) was set up, and

it in turn spawned an Accounting Standards Board. This has, as I write, issued some fourteen standards.

A noteworthy feature of the British story is that on one occasion -- when the date approached for implementing the standard on inflation accounting -- unofficial members of the English Institute put up a motion designed in effect to reject the standard. Despite the admonitions of the leadership, the motion was carried at a substantial poll. We could long debate whether this revolt shows the members as deplorable stick-in-the-muds or as men too wise to swallow half-baked proposals.

Growth of mandatory powers

The disciplinary powers of accounting institutes vary from country to country, but usually are mild. Unaided, institutes could hardly force their own members, let alone outsiders, into complete compliance with a standard. A big body must inevitably contain rebels; even conformists will on occasion find some standards inconvenient and inept. Non-members, including powerful groups such as company directors, are not under the slightest obligation to accounting bodies, and might be expected to brush standards aside whenever it suits them. (And, to complicate matters, the non-members may fall into conflicting sides. Thus the owners of small companies may favor profit rules that minimize early tax. The managers of big companies may favor instead flexible rules that smooth profits from year to year. Ideally, such partisan interests should not influence our reasoning on abstract principle; in the real world, they are likely to carry much weight.)

But the degree of compliance has in fact been substantial. The institutes have high prestige, and can count on the loyalty of members. And the standards boards are reinforced in several ways. First, the auditor of a non-complying company should disclose departures from standards. This threat has been a considerable deterrent. (In Britain, however, there have now been so many qualified reports -- with no serious harm to the delinquent companies -- that this weapon is losing its edge.) Again, other kinds of (non-governmental) bodies may serve as allies to the accountants. Thus stock exchanges in both America and Britain have threatened to withhold quotations from offending companies. Such threats serve to deter at least companies that are big and want to expand further.

But the above constraints are small beer compared with sanctions imposed by government. Such sanctions may take oblique forms (e.g. tax requirements), or be more direct. In America, the SEC has made the FASB's standards mandatory for companies under its surveillance. The British government hints darkly at a law on inflation accounting if the profession cannot make up its own mind on a standard.

So we have gone far since standards first appeared. They started as gentle guides; they now are becoming firm rules, backed by sanctions.

But they have not yet been tamely accepted everywhere. Perhaps it is correct to say that the most successful rebels are not stray mavericks but powerful companies grouped as an industry and seconded by big auditing firms (e.g. oil companies in U.S. and real estate companies in Britain). Their strident protest -- sometimes aided by political action -- can win modification of principle. A well-enough financed lobby could probably amend the law of gravity.

The Anatomy of Standards

Let us next look at the structure of standards. Usually they consist of three parts:

- (a) A description of the problem to be tackled:
- (b) A reasoned discussion (possibly exploring fundamental theory) of ways of solving the problem. Then, in the light of decision on theory:
- (c) The prescribed solution.

So here we have an instance of authority telling us how both to think and act.

Rules of action versus truth

It is important for our argument to distinguish between the two forms of pronouncement by authority.

The first is a bald rule on how we are to act -- a command to behave in this or that way. If such commands make life run more smoothly, they may well be good. Thus a law compelling drivers to keep to the right (or left) of the road helps us all; again, the rules of a sports association makes games more enjoyable.

The essence of these good "standards" is that they consist only of part (c) of the above list. They stress *what* we are to do, but say little about *how* and less about *why*. They steer clear of (b), principles. Sporting rules work well though they say nothing about the dynamics of tennis balls or the psychology of footballers. Note that auditing standards can confine themselves to (c), rules of action. This may help to explain why they arouse less criticism than accounting standards.

Admittedly, the men who draft rules of action must sometimes be swayed by theory. A legislature may have to choose between rival theories, e.g. public health law may assume that Pasteur was right. Yet this kind of rule does not set a seal of approval on a theory. It merely enables us to follow a hopeful line of action; if the rule does not work, it can be scrapped without loss of face. A legislature that endorses a theory -- as when Tennessee backed fundamentalism -- is straying beyond its proper function, and must antagonize all who value freedom of thought.

Sometimes *definitions* are tacked onto rules. They can be helpful if they make the given rules work better -- but not if they are regarded as applicable elsewhere, still less if they are viewed as revelations of truth.

With accounting standards, the frontier between (b) and (c) must often be hazy. You may indeed feel that I am pedantic to stress it. But it lies near the heart of our problem. If a standard confines itself to (a) and (c), it may or may not be a useful rule of action; at least, it can be judged by how it works. When it includes (b), it incurs two extra risks: its reasoning may be false, and it will impede other attempts to reach truth.

Subject-Matter of Standards

Such ideas are reinforced when one considers the subject matter of standards. These deal with different subjects, and vary in quality accordingly. Four types can be distinguished. (3)

Type 1 states that accountants must tell what they are doing, i.e. their published reports must explain what "accounting policies" have been followed.

Type 2 aims at uniformity of layout and presentation. U.S.A. and Britain have so far tended to by-pass this type. Germany and France, on the other hand, favor standardisation of layout, with numbered classifications in balance sheet and income statement. The international standards of the future may well impose similar requirements.

Type 3 calls for disclosure of specific matters, notably where the reader ought to exercise his own judgement. Examples of such matters are research and development cost, depreciation, and extraordinary items. Type 3 can perhaps be stretched to cover also the demand for a flow of funds statement.

Type 4 tells us how we should measure economic phenomena -- i.e. what are the approved concepts for asset valuation and income assessment. It deals for instance with depreciation methods, inventory

values, deferred tax, and foreign exchange.

Critique of the four types

It is hard to quarrel with the aim of *Type 1* -- to make accountants explain the assumptions and policies of their published reports: "it is an elementary but fundamental rule of statistical presentation -- and indeed of simple good sense, manners and respect for your audience -- to make it clear how your figures have been completed" (4)

Standards of *Type 2* are not quite so attractive. Uniform layout has its advantages: thanks to it, we do not need to waste time hunting for given items. But it carries the obvious risk that the layout will become a strait-jacket -- that it will not suit all kinds of firms, and will stop experiment. The style of published accounts has improved enormously in recent years, and there is no reason to think that the process cannot go further if left unfettered.

So far as *Type 3* merely calls for more disclosure, it is free from objection (unless indeed the flood of standards leads to an indigestible quantity of details and notes). But of course it will not prevent differences of judgement on e.g. what constitutes "extraordinary".

It is *Type 4* that should arouse most doubt. For here a standards board debates principles (or sometimes tries to think up new ones); it weighs the *pros* and *cons* of different theories, and decides for us that one is the best. In short, authority here informs us where the truth lies.

History suggests that authorities have in the past not been too successful at this task. The most eminent authorities erred persistently on, for instance, the shape of the earth, the origins of life, and the circulation of the blood; more recently, the council of the English Institute has gone badly off the rails with its pronouncements, from 1949 onwards, on inflation accounting. We cannot with complete confidence expect infallibility in the future.

The Good Side of Standards

If we are to criticise fairly, we must spell out the benefits that standards confer.

Standards have greatly reinforced the process of improvement in published reports. They provide stockholders with figures that are fuller, clearer, and more consistent. In this respect, they act rather like additions to company law -- supplementing it where it is weak. Often indeed standards have paved the way for new law (e.g. Britain's companies acts) and for new regulations with semi-legal force such as those of the SEC. Standards may thus play a useful role as ways of testing out new methods.

So far as they foster comparability, standards help analysts and potential investors; there is even something to be said for the view that it is better if all firms issue second-rate figures on the same basis than first-rate figures on conflicting bases. Standards are useful also to government, for tasks such as price-control. If Congress is to understand the oil industry, the producers' figures for cost and profit must be presented on the same basis.

Standards deserve some credit for stimulating interest in principles. When new standards are proposed and published as exposure drafts, they often give rise to fierce dispute -- and this is surely preferable to apathy.

Why Do Other Disciplines Not Use Standards?

If standards confer such patent benefits, we should perhaps ask why most other professions fail to produce them.

There seems nothing to stop engineers, doctors, and so on -- if so minded -- from following our example. Thus a medical body could set up a committee of its distinguished experts to formulate standards for the treatment of this or that intractable disease. Such rules might well spur on wayward doctors to give better treatment; they also would shield doctors accused of negligence. Similarly an engineers' association could produce standards on the design of motor-cars.

But these bodies do not in fact issue standards. Some of the reasons are obvious. A conscientious doctor will wish to use his judgement on each patient; he may feel that diseases show a rich variety, and patients cannot be stretched into a Procrustean bed. Some doctors -- including able young innovators -- will believe that the standard's treatment is not in fact the best. And knowledge keeps expanding: even the non-controversial best of today will be tomorrow's second- or third-best, so that standard treatment would usually be obsolete treatment. If computer experts complied today with the very best standards of a few years ago, their lives might be more comfortable, but their craft would not have made the giant strides that in fact occurred, and society would be poorer. In these dynamic professions, we may safely conclude, standards would hamper rather than help; and the members would hardly regard themselves as "professional" if they evaded personal responsibility and judgement.

Pure scientists would have even less use for standards. We cannot imagine a society of economists or physicists setting up a committee to issue solutions to puzzling problems. There are several reasons why any such attempt would be laughed out of court. A minor one is that committees, though often useful for collecting facts or deciding on joint action, may not be good at finding ideas: members may think best in solitude; and, sitting in committee, they may be hampered by the need for tact and compromise, or by pressures from outside. More important is respect for scientific method. Presumably a good scientist accepts that his aim is to test and attack hypotheses. He functions best as a Doubting Thomas, not a believer. His knowledge of history tells him that "scientific laws" can never be viewed as final. It tells him too that knowledge flourishes best where there is complete freedom of thought. And this means the absence, not only of crude tyranny, but also of any benevolent authority that makes us respect some ideas and discount others. Ideas should be democratic. As Bacon put it: "Truth is the daughter, not of Authority, but of Time".

Do Analogies Apply To Accounting?

Accountants no doubt concur with such views on scientific standards -- and yet continue to support accounting standards. We must therefore presume that they regard the analogy with science as imperfect.

How far can one agree that accounting "truth" differs from scientific "truth"? Where some areas are concerned, the argument has strength. Take income realisation. Accounting is here concerned with the growth of wealth. But the size of a firm's wealth can, quite properly, be expressed as a whole range of conflicting figures, varying according to the point at which the bird is deemed to leave the bush and reach the hand; none of these figures may be "untrue", but some will be nearer to "true" than others, in the sense of being more useful and reliable for the given user and purpose. In such areas, accounting is more a matter of sound judgement -- than of measurement in the physical sense. On the other hand, there are plenty of areas -- such as decision budgets and inflation accounting -- where strict economic logic applies.

It may be helpful to try to find a closer analogy. Suppose government tells the actuaries of insurance offices to file operating statistics each year; and further, in order to aid understanding and comparability, prescribes the formulae (for assessment of risk, etc.) to be used in calculating the figures. Such a standard seems free from objection. Its rules are a mere matter of convenience. They do not absolve the actuary from the need for judgement on which formulae to use elsewhere, and they do not stop him from experimenting to find better formulae. He does not lose integrity if he dutifully applies the formulae for the government's purpose, and repudiates them elsewhere.

This analogy is perhaps more apt than that of the scientists. But, alas, it too does not fit the facts completely, and should afford us little comfort. Published accounts are not mere incidentals to the accountant's work -- something to be filed and forgotten. They are central to it. He cannot shrug off responsibility for their figures, or for the principles on which he prepares them.

The Grounds for Pessimism

So where has our argument brought us? To their credit, accountants are intent on improvement. They believe that standards are the means (and that accounting differs somehow from other kinds of work, where standards would be useless or disastrous). The belief rests on two grounds. First, if we all keep in step, no-one can charge us with inconsistency. Second, and more important, is the view that a committee of leaders can find right principles.

So we demand more and more standards, and accept the big cost of the bureaucracies that will promulgate and police them.

The process of issuing standards has acquired such momentum, and aroused such high expectations, that we must accept it as irreversible -- at least for the time being. Presumably it will someday reach a point of equilibrium -- where those who call for still more standards are checked by those who are sated.

But if we must willy-nilly live with standards, we should be wide awake to their defects and dangers. Let us look at these squarely.

(1) The most important is concerned with the logic of science. Only god-like creatures know where the truth lies. *Ex cathedra* pronouncements by human authority are pretentious, and inevitably must be wrong sometimes. To trust them is to ask for disappointment.

(2) The essence of a profession surely is that each member is willing to think and judge for himself. If members abdicate from such responsibility in favor of a ready-made code, they cease to command respect: in time, moreover, they will become less able to think and judge.

(3) Men soaked in rules soon begin to mistake rules for reality. To quote again from Bacon: "The first distemper of learning is when men confuse words with matter". The successful accountant and auditor will be he who is best at hair-splitting and casuistry, not he who best pictures the economic facts.

(4) Standard procedures may become petrified procedures.

(5) Accounting figures are not docile, and do not lend themselves to standardisation. Industries differ from one another. So do firms within an industry (or, very likely, straddling several industries). The same firm may change from year to year. And the needs of users vary. So, if standards are aimed to suit the "average", they may be quite unsuitable for the fringes.

(6) The wording of standards will inevitably bring difficulties of interpretation: If they are broad enough to cover the variety of circumstance, they become platitudinous and admit the very disparity of treatments they were designed to avoid; if they are narrow enough to exclude this, then all sorts of hard cases will come up with a silly result.⁽⁵⁾

(7) Standard-makers may have to bow to political pressures. Already one hears the argument that standards ought to further desirable political and social ends.⁽⁶⁾ Most of us would answer that figures can best further desirable ends by being unbiased and accurate. Note too that a group bound by a rigid code can be manipulated by government far more readily than one where individuals act in freedom.

(8) Even if a standard lays down a principle well, it may leave scope for personal estimate: we must still choose the figures to be slotted into the formulae. And many of the figures must be a subjective compromise, with plenty of room for disagreement. In most fields of physical measurement,

disagreement over size will rightly suggest that the measures (or their instruments) are at fault. In contrast, we expect some disagreement between judges of (say) ice-skating, or diving, or beauty; such disagreement is far from suggesting incompetence. The estimation of wealth is probably closer to judging in a beauty competition than to physical measurement. Sooner or later, our profession will have to recognize that standards cannot guarantee identical estimates by different accountants, and that we must educate the public on the point. Until we do so, we shall continue to be fair game for our critics.

If you are disposed to agree about any of these dangers, then you must agree too that optimism would be misplaced. Standards will bring many setbacks and much disillusion.

Safeguards

The possible dangers in accounting standards could be lessened in various ways:

- (1) As [page 30](#) pointed out, standards normally lead up to their conclusion with a section that explores various principles, and then backs one of them. The briefer this section, the better: authoritative pronouncements on principle are unwise. There would be a strong case for limiting a standard to a bare statement such as that the recommended procedure is already the most usual one.
- (2) The same reasoning tells us to be wary of the *Type 4* standards of [page 12](#). They are more prone than *Types 1, 2, and 3* to stray onto thin ice.
- (3) Pronouncements on theory are less likely to overawe us if they are described as the work of named persons. We all know that individuals can err; we tend to credit institutions with more wisdom. Therefore it would be helpful if standards were signed. Moreover a dissenting opinion adds a valuable dimension. So does an admission that an earlier standard was wrong.
- (4) A standard should not pander to political ends.
- (5) A standard should be explained in terms of normal behavior -- a rule to be followed so long as it fits the facts. The accountant should be free -- indeed obliged -- to depart from it when he judges that it will distort the picture. Deviation from standards should of course be described and justified, where possible with a numerical estimate of its effect.

Standards and Intellectual Training

My paper has (I fear) done more to list problems than to solve them. But on one point I am clear. Let us agree for argument's sake that standards -- particularly if issued with safeguards -- may for a time do more good than harm in the world of practice. I still find it hard to feel anything but gloom about their effect on education.

The study of standards now plays a big part in any accounting curriculum. They must have a profound influence on students, just when these are at their most impressionable and uncritical. You have only to look at an up-to-date textbook to see how much weight is given to official pronouncements, how little to the economic reality that accounts are supposed to show. Standards are a godsend to the feebler type of writer and teacher who finds it easier to recite a creed than to analyse facts and to engage in argument. If an official answer is available to a problem, why should a teacher confuse examination candidates with rival views? Thus learning by rote replaces reason; the good student of today is he who can parrot most rules. On this spare diet, accounting students are not likely to develop the habits of reasoning and skepticism that education should instill. (7)

And the student will have little cause to abandon his passive attitude when he leaves the university and enters practice. Here too he must be the respectful servant of standards. We may indeed envisage a brave new world in which an accountant spends his whole life applying rules pro-pounded by others --

unless at last, full of years and honors, he himself ascends to the Accounting Principles Board, and then for the first time must face reality.

I am sorry to end so glumly. But the trend in accounting education must make one pessimistic. For many years, academic critics viewed accounting -- wrongly, to my mind -- as unworthy of a place in higher studies. It got in at last. Now that we are substituting rule-of-thumb for reason, one must sadly admit that our critics were right.

(1) *The Accountant*, December 12, 1942, p. 354.

(2) For full details, see John L. Carey, *The Rise of the Accounting Profession*, New York: American Institute of CPAs, 1970.

(3) I here follow the classification of Harold C. Edey, "Accounting Standards in the British Isles", in Baxter and Davidson, *Studies in Accounting*. 3rd. edition, London: Institute of Chartered Accountants of England and Wales, 1977, p. 294. This, and its companion article by A.M.C. Morison, argue the pros and cons of standards. Rather unexpectedly, the academic author is on balance favorable, whereas the partner in a large firm of chartered accountants is mercilessly hostile.

(4) Edey, *op. cit.*, p. 296

(5) Morison, *op. cit.*, page 279

(6) Professor David Solomons argues this point with his usual skill in "The Politicization of Accounting", *Journal of Accountancy*, November 1978, page 85.

(7) If this is right, then academic bodies such as the American Accounting Association are naively self-destructive in swimming with the tide -- and indeed adding to the output of Holy Writ.

QUESTIONS AND ANSWERS

Question:

Professor Baxter, I am particularly intrigued with your analogy with the other professions and their failure to develop standards such as the accounting profession has been developing. I'd like to get some elaboration on your thinking on this. Is it not true that the medical profession and the engineering professions are basically based on the physical natural sciences whereas accounting, in essence, is a social science. The interplay in, let us say, medicine, is between the doctor and a single patient, and of course, with the engineer, he might reach more people in the impact of his work, but the accountant really deals with almost the entire world. There is a whole mass of potential in existing investors, and potential in existing creditors that have to deal with an enterprise and they are looking for some order, for some discipline, for some assurance that the representations that they deal with have met the standards agreed upon by people in the know. What is the impact of this on your comparison?

Answer:

Well, it's a nice problem whether there is a fundamental difference here. As I said, I think it rather depends on which bit of an accountant's work you are thinking of. The great argument on your side would be, surely, that for the benefit of readers of accounts there should be some uniformity. The instance I cited, that of Congress dealing with oil companies, is perhaps the most persuasive that I can give. But this leads on to the thought that if we all do the same thing we shall in some instances not be giving the best possible picture. As I said, what suits the average won't suit the fringes; and I think we have to see whether experience suggests in the end that figures disciplined in the wrong way are better than ones which are not comparable but nevertheless do show each company in a clearer light. Is it better, in other words, that there are second-rate figures, all prepared on the same basis, or first-rate

figures prepared on different bases? This, I think, is one of the questions to which time alone will show the answer.

Comment: Prof. Briloff.

Professor Baxter, your presentation was nothing short of inspiring, and as I commented on a number of occasions to Professor Mellman, who was sitting next to me, as a matter of fact, Professor Baxter, I know of only one Saxe lecturer with whom I agree more than I agree with you. I am afraid that as we talk it out you'll see the point I now want to make. It may very well be that the critical flaw lay in the confusion of tongues, and by that I mean by using the very word 'standards' for the kind of mischief that's being perpetrated up in Stamford. No, we know how the term began. It was the word opted for by the Wheat Committee, probably inspired by Professor David Solomons, who undoubtedly read the work by Professors Paton and Littleton, going back some 40 years ago, an inspired work called "An Introduction to Corporate Accounting Standards," where Professors Paton and Littleton made the point that the Wheat Committee study made, that 'principles' is a presumptuous term when used in accounting, therefore we ought to have standards, and they explained it in the most beautiful, soaring terms as to why standards were appropriate. But then, Professors Paton and Littleton made abundantly clear, that standards are not to be implemented as rules. They are, instead, to be guides to more effective, better action. Now what's happened up at the FASB, like with the Accounting Principles Board, is this pretentiousness of saying that rules are standards, and I believe we fall into their trap by pretending that we are talking about standards. I submit that every profession, including those that you enumerated have standards. As a matter of fact, the very terms that you used, Professor Baxter, scientific method and all that that implies, indicates standards to the scientist. We know the Hypocratic oath, standards for the physician. We know the philosophy of the judicial process, standard for the judiciary. But they are to be severely distinguished from rules. And so it is, that what's been happening is that we've been perpetrating mis-chief by setting forth a catechism of rules which then are capable of being bent and defied and all the time we are saying to the world, we are moving with standards. Professor Baxter, in sum, I believe that the problem with accounting can best be summarized by saying, it's not a matter of accounting principle, but a matter of principles of the accountants.

