

**THE END OF THE DISINTERESTED PROFESSION:
AMERICAN PUBLIC ACCOUNTANCY 1927-1962**

A Dissertation

by

MICHAEL E. DORON

Submitted to the Office of Graduate Studies of
Texas A&M University
in partial fulfillment of the requirements for the degree of

DOCTOR OF PHILOSOPHY

August 2009

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Approved by:

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ABSTRACT

The End of the Disinterested Profession: American Public Accountancy

1927-1962. (August 2009)

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This study traces the development of the American public accounting profession from 1927 to 1962. Over the course of these thirty-five years, accounting evolved from an insular, divided group whose professional competence and independence was doubted, even by its own members, to one that spoke with one united national voice, proudly asserted its ability to take on additional responsibilities, and had cemented an essential place in the American economy. The study makes use of archival sources, included large portions of the papers of George O. May, the doyen of the old Wall Street elite whose correspondence into the 1950's reflects the profession's development, and provides the first study of the accounting profession's response to the union corruption scandals. I look at the major events that caused this evolution, including the writings of William Z. Ripley, the New Deal and the creation of the Securities and Exchange Commission, the McKesson-Robbins scandal, the Second World War, the postwar economic expansion, and the union corruption scandals. I show how these events forced

the profession to accept the responsibilities American society demanded of it, and how the leadership of the profession passed from a Wall Street-centered elite that styled itself after a British ideal of the professional as a disinterested, independent gentleman who did not promote himself and whose integrity and expertise did not require rigid rules of conduct, to a new generation that embraced a more modern ideal of the professional, one who followed strict rules of conduct and educational requirements, and who embraced a broader vision of public accountancy's responsibilities to American society, as evidenced by the prominent public role the American Institute of CPA's took when Congress looked to impose stricter regulations on trade unions and pensions in the wake of the union corruption scandals of the late 1950's. Finally, I evaluate the consequences of this evolution, consequences that I believe persisted into the twenty-first century with the debate over non-audit services in the wake of the Enron scandal.

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CHAPTER I

INTRODUCTION

This dissertation is a case study of a profession, American public accountancy. Specifically, I focus on the auditors of corporate financial statements. Certified Public Accountants prepare tax returns, serve as consultants to business, and work as managerial accountants within corporations themselves. But the flagship service of the profession is the audit report of a company's financial statements issued by an independent CPA (i.e. hired by the company to perform the legally required function of a financial statement audit). The report is an official seal of approval of the company's publicly disclosed financial information. The auditor states that "in our opinion, the financial statements...present fairly, in all material respects, the consolidated financial position" of the corporation. This certification provides assurance that parties outside the corporation, particularly creditors, shareholders, and potential investors, can use the financial statements to evaluate the company's financial health. If investors do not trust the accuracy of the financial statements, they will be reluctant to invest, and the capital markets that fund American business may grind to a halt.

I focus on the crucial years of 1927-62, when accountants evolved from an insular, divided group with an uncertain mandate from American society for its services to a profession eager to promote itself and to expand its reach and responsibilities. From the beginning of the push to reform America's capital markets with William Z. Ripley's

This dissertation follows the style of *Accounting History*.

1927 polemic *Main Street and Wall Street*, up to the 1939 McKesson-Robbins audit scandal, the leadership of the profession shied away from reformers' entreaties that accountants raise their public profile and their independence from corporate clients. But in the wake of McKesson-Robbins, and the democratization caused by a geometric expansion in the profession's ranks, a new generation of leaders began to take a more expansive view of the profession's proper role. Faced with pressure from regulators and from competing professions, they were forced to act, defensively, to maintain their status as a profession. As I will describe, the American market for professional services forced CPA's to raise their professional standards, engage in public relations to educate the public about their contribution to financial stewardship, accept increased responsibilities and legal liabilities by expanding the audit franchise to pensions and labor unions, and finally to actively promote the CPA's skills as a business consultant in testimony before Congress in 1962.

The two decades after McKesson-Robbins and including World War II and the postwar economic expansion were a critical time in accounting's history, when thousands of new CPA's shifted the focus of public accounting's national leadership, embodied in the American Institute of Accountants (later the AICPA), away from the large accounting firms and towards the needs of the small practitioner. In doing so, the profession consolidated the power needed to protect its exclusive right to conduct financial statement audits. It also adopted a more aggressive and self-interested stance in its agenda, eagerly seeking out new venues, and new revenue, for the CPA's skills. This had both beneficial consequences, by forcing the AICPA to take responsibility for

the standards of all practicing accountants and to embrace an ethic of public service, and ominous ones, by nudging CPA's into the high-margin, high-risk field of consulting. My goal in this dissertation is to both describe this evolution and evaluate its consequences for public accounting in America, consequences that I believe are still being felt today.

Sriram and Vollmers (1997) divide the study of American public accountancy into two models: Functionalist and Conflict. In the Functionalist model, "The primary assumption...is that the profession is devoted to the public interest, to human welfare." The Conflict model, by contrast, "assumes that self interest is the dominant motivation of a profession" (Sriram and Vollmers, 1997, p.3). The Functionalist model has been largely limited to official histories and memoirs. The Conflict model is much more descriptive of scholarly work on public accountancy and on professions in the United States in general. Seemingly every historian who has evaluated American public accountancy has been critical of the profession's reluctance to increase its standards of professionalism and to accept the responsibilities society demanded of it. David Hawkins wrote that prior to the reforms of the New Deal, "the influence of the...public accounting profession was severely curtailed by the unwillingness of much of their membership to act independently of management" (Hawkins, 1963, p.149. See also McCraw, 1984, pp.189-90, Miranti, 1990, p.153, Sriram and Vollmers, 1997, p.6, and Previts and Merino, 1998, pp.293, 318). But I believe that to some extent their judgments are premature because they focus only on the 1930s, often ending with a cursory summary of the McKesson-Robbins scandal of 1939 (Sriram and Vollmers,

1997, Miranti, 1990). Sufficient attention has not been given to the aftermath of McKesson-Robbins, and the changes in the profession's leadership that it began.

The American Institute of Accountants, composed largely of Wall Street-centered CPA's, and modeling themselves after a nineteenth century British ideal of professionals as disinterested gentlemen serving a select clientele, had seen their grip on the profession weakened by the 1929 stock market crash and the new regime of regulation and legal liability imposed by the New Deal's Securities Acts. This self-styled elite was forced to merge with their chief rival, the American Society of Certified Public Accountants, in 1937 as a counterweight to the stricter oversight being imposed by the newly created Securities and Exchange Commission. The McKesson-Robbins scandal, which publicly revealed the inadequacy of accountants' professional standards, undermined the elite's claim to leadership. Over the next two decades, a vast expansion of the profession's numbers, spurred by a demand for more trained accountants to replace the use of temporary workers identified as a major cause of the McKesson-Robbins scandal, by the domestic labor shortage during World War II, and by the postwar economic expansion, brought new leaders to a unified AIA, mindful of the power of public relations and responsive to the needs of the small practitioner CPAs who made up an increasing and increasingly dominant majority of the profession.

The methodology of archival history is storytelling, the goal being to provide insight into phenomena through detailed if unscientific reconstruction of the event's origins and development. It can form the basis for testable hypotheses and convey the ambiguity of human motivations that more formal research methods often miss.

Statistical research, while more conducive to identifying patterns and forming generalizable conclusions, is limited to questions that can be “operationalized”, or properly abstracted from real life to discrete relationships. A particularly relevant example is the journalist Kurt Eichenwald’s study of the Enron debacle, *Conspiracy of Fools* (2005). Accounting research prior to Enron was unable to find support for the seemingly obvious hypothesis that accounting firms’ integrity was compromised when they did consulting work for clients they also audited (Kinney, et al, 2004, p.563). Eichenwald’s recreation of events, done through interviews with the participants and an exhaustive study of documents, provides incontrovertible evidence that such a conflict did exist in Arthur Andersen’s dealings with Enron, and insinuates that it must have occurred elsewhere.

In this chapter, I will first define professions as they exist in the United States. I will next review the relevant literature and place my thesis in the context of these works. With this foundation, I can outline the role public accounting plays in American society and expand on my thesis that the market for accounting’s services successfully molded the profession to fill this role. Finally, I will compare the story of accounting’s professionalization with that of other American professions and professions in Europe.

A profession can be defined as an occupation that requires licensing from the state. A few basic characteristics of professions in the United States and England can also be asserted with little controversy: a profession has some sort of expert knowledge, is largely self-policing, controls its own membership, and works under some form of social accountability. In the United States as well as England, this social accountability

is achieved chiefly through legal liability. For accounting, medicine, the law and other licensed professions, the right to be sued for professional mistakes is the chief method of control society retains over otherwise self-governing professions. Discipline of members is controlled by the professions themselves, through such methods as censure, suspension, or in rare cases expulsion from professional ranks. In his study of management consulting, *The World's Newest Profession* (2006), Christopher McKenna writes that the refusal to accept standards of legal liability marks management consultants as something less than true professionals.

But this does not answer the question of what role society asks professions to play. Most writers will usually characterize professions as vaguely serving some higher calling. As Nathaniel Hatch summarized the professional ideal: “The professional person, it has been said, does not work in order to be paid but is paid in order to work” (Hatch, 1988, p.2). Viewing this somewhat more cynically, Andrew Abbott compared the position of professions in England and the United States with that in Europe: “General social obligations are more formal among continental professions than among Anglo-American ones. The relative power of continental governments has allowed them to place and enforce such obligations on the professions; in America these obligations are merely paraded in the preambles to codes of professional ethics” (Abbott, 1988, p.60). This outlook can be traced to the sociologist Talcott Parsons, who wrote that we ostensibly ask professions to serve society, but in practice they exist largely to serve themselves (Parsons, 1939, p.458, Schleef, 2006, p.5). Parsons saw something resembling market forces working to define and enforce professions’ role in American

life. Professions exist in the same market economy as business, and are inexorably drawn into this dynamic. This description owes much to Abbott's model of jurisdiction, from his book *The System of Professions* (1988). For Abbott, professions exist in a dog-eat-dog world where they fight with each other for professional space, or jurisdiction. He argues that this model fits the actual pattern of professional work much better than traditional studies: "Most authors study professions one at a time. Most assume that professions grow through a series of stages called professionalization" (Abbott, 1988, p.1). As Abbott describes, it is interprofessional competition, not a profession's development in isolation from other professions, which defines it. In order to carve out their space, a profession must define its expert knowledge and then convince both government and the public at large that this knowledge is both useful and exclusively theirs.

I have found this concept particularly useful in describing the process that shaped accounting in the United States. Once a profession gains a viable jurisdiction, its *raison d'être* is to retain this professional space. It was to maintain its jurisdiction that accounting took on new responsibilities in the years 1927-62. Threatened by the SEC with losing the right to set accounting standards in the 1930s, accounting's two rival national associations merged in 1937 to take all CPAs under one umbrella and speak with one voice to protect their space. Threatened again by the McKesson-Robbins scandal and beset by a mass of new CPAs as the labor shortages of World War II and the postwar expansion threatened to overwhelm the old guard leadership, the profession shifted its focus to the needs of the small practitioner and took responsibility for the work and standards of these new

members. And threatened during the union corruption scandals with losing their exclusive franchise to conduct financial statement audits to unlicensed public accountants, the profession was ready to offer its expertise to aid American society by helping to bring financial order to unions and pensions. By 1962 the concerns about self-promotion and taking on new responsibilities and legal liability had been cast aside, as the president of the AICPA proudly testified before Congress of the CPA's expertise as a man of business. The old-guard leadership of the accounting profession, proud of its hard-won place auditing America's big businesses, resisted all these steps out of fear that the pedestrian work of small practitioners and the suspect financial propriety of unsophisticated entities like labor unions threatened their image of the profession, an image rooted in the nineteenth century that was incongruous with the American economy of the mid-twentieth century.

As I describe in Chapter V, I use the term "disinterested" in the title to suggest the tension within the profession as to how accountants understood their role in the American economy. Prior to the late 19th century, professions were generally class-based. The wealthiest clients were served by a small coterie of men who had been trained through some sort of apprenticeship system. These individuals could rely on a financially secure career by serving their exclusive clientele, providing they followed a gentleman's code. Such a code disdained soliciting clients, advertising or any form of self-promotion, or competition with other professionals (Wiener, 1981, p.14-16, Bledstein, 1978, p.192). This was the ethic that the original leaders of the American accounting profession, many of them transplanted British accountants, inherited. But for

the modern professional, working in a world where money speaks much more powerfully than class, the disinterested model can seem naïve and antiquated. The state enforces professional monopolies over work through licensing and education requirements, and a profession that cannot justify itself can find its jurisdiction threatened.

Before the New Deal, the certified public accountant played an uncertain role in the American economy. In the 1920s, large, publicly traded companies increasingly obtained annual financial statement audits, but the audience for these audits was generally limited to creditors (mostly banks). These were sophisticated financial statement readers with both the expertise to parse the statements and the access to management to request additional inside information. Audits as yet were not designed to serve the small equity investor, who businesses increasingly turned to for funding (Previts and Merino, 1998, p.249). It would be the writings of William Z. Ripley, first in a series of articles in *Atlantic Monthly* and then in his 1927 book, *Main Street and Wall Street*, that first looked to the accounting profession to serve the financially unsophisticated small investor. The New Dealers, in writing the Securities Acts of 1933 and 1934, adopted this viewpoint. They understood that the small shareholder lacked the time and expertise necessary to effectively monitor management (Draft of article prepared for Sam Rayburn, Landis Papers 9-2). It would take “financial gatekeepers”, including lawyers and public accountants, to fulfill the role of watchdog in the American system of corporate governance. While Boards of Directors ostensibly exist to serve as

shareholders' representative within the corporation, "All Boards of Directors are prisoners of their gatekeepers" (Coffee, 2006, p.1).

American exceptionalism, or the emphasis of historians on what is unique in the American experience, is nowhere demonstrated more clearly than in the American system of corporate governance. "Unlike any other nation state in the modern world, the very idea of government power is stigmatized in the U.S." (Ellis, 1997, p.296). The anti-statist ethos that characterizes Americans' relationship with their government meant that there were few checks on American big business as it evolved in the late nineteenth century. An ad-hoc system of government regulation began with the ICC regulation of the railroads and continued into the Progressive era. The Blue Sky Laws, the uneven and largely ineffective state regulations of securities issues, were typical of America's approach to monitoring business in the years before the New Deal. But more crucial, as Mark Roe describes, was Americans' fear of power concentrating in the hands of financial titans. This made the development of large financial intermediaries who could serve as effective monitors of corporate management impossible in the United States: "American law and politics deliberately diminished the power of financial institutions in general...American politics repeatedly prevented financial intermediaries from becoming big enough to take influential big blocks of stock...a process that began as early as the nineteenth century with the destruction of the Second Bank of the United States. Thereafter, each state created its own separate banking system, making the U.S. banking system the most unusual in the developed world" (Roe, 1994, pp. 6, 21).

In the wake of the 1929 stock market crash and the ensuing Great Depression, the

New Deal codified limits on financial intermediaries' power, by separating commercial and investment banking with the Glass-Steagal Act. In place of large financial intermediaries to monitor big business, the New Deal created the Securities and Exchange Commission to protect the interests of the millions of small investors who would fund American big business. But the SEC has generally lacked the staff and the expertise to fulfill this mandate effectively, and so America came to rely on financial gatekeepers, including accountants, lawyers, and the press, to look over the shoulders of American big business (Seliman, 1982, pp. 197-201; Chatov, 1975, p.178).

It did not have to be this way. The United States could have developed its capital markets along the model of the European Continent. In an influential study, Ball, Kothari and Robin (2000) divide developed economies into "common law" and "code law" countries. They label countries where stakeholders lack access to insider information, and thus depend on credible public disclosures, as common law countries. In BKR's sample, these include the United States, United Kingdom, Canada and Australia. Countries where capital market investment is more concentrated through institutions such as banks are labeled code law countries. In their sample these include France, Germany, and Japan. BKR hypothesize that in common law nations, public disclosure through financial statements is a vital corporate governance mechanism. In code law countries, the job of monitoring management is done by large stakeholders such as banks, other financial institutions, labor unions, government, suppliers and customers. These groups have close relationships with firms and access to insider information. In code law countries, as BKR write, "there is no presumption that parties

operate at a distance”, and so communication devices such as financial statements are less important (Ball et al., 2000, p.15). But in common-law countries, only management is privy to inside information, and so credible disclosure becomes the primary means of corporate communication with investors. This is the system the New Dealers put in place, with the preparation of transparent, reliable financial statements serving as a cornerstone of the effective functioning of capital markets.

But the American accounting profession proved reluctant to accept this role. Two rival national organizations represented accountants when the Securities Acts were implemented, neither of them with a clear agenda. They did not possess clear control over membership into the profession and they lacked standards for legal liability. When William Z. Ripley put accountants in the public spotlight with *Main Street and Wall Street* in 1927, his chief criticism was that accountants lacked the independence from their corporate clients that would make them effective watchdogs. James Landis, chief author of the Securities Acts and later Chairman of the Securities and Exchange Commission, saw developing accountants’ professionalism as one of the SEC’s most pressing challenges. For the most part, as we will see, accountants feared the risks of legal liability that would come from greater responsibility. It would take a generation, and a geometric increase in the profession’s numbers, for public accountancy to achieve the standards Ripley and Landis envisioned for it.

American law and medicine endured similar growing pains. The American Revolution left the legal profession’s numbers in the new nation depleted as loyalists fled the new nation, and what had been an elite profession in the colonial era became

more egalitarian through the Jacksonian era that “witnessed the general disestablishment and humbling of the professions in America” (Numbers, 1988, p.52). For most of the nineteenth century, American law remained divided into a class-like structure, with the profession’s elite distancing themselves from the vast majority of the profession.

The Progressive Era has been labeled the Gilded Age for the growth and consolidation of professions that took place in these years. The dizzying array of changes that the United States witnessed in the late nineteenth century, from the expansion of railroads and proliferation of communications technology to the emergence of big business and teeming urban slums brought about fundamental changes in American society. A new middle class order centered in the city replaced the small town ethos that had defined American life. This order imbibed the lessons of science and sought organized, bureaucratic control. “Men were now separated more by skill and occupation than by community” (Wiebe, 1967, p.xiv).

This mentality was obviously a boon to American professions. Like accounting, the law’s elite practitioners had disdained expansive written ethics codes, preferring to leave these decisions to the lawyer’s professional judgment. But over the course of the nineteenth century, the expansion of the number of practicing lawyers forced the profession to take more aggressive actions to defend their jurisdiction. They took steps to limit membership, particularly by organizing accredited law schools that taught a standardized curriculum, and worked to prevent title companies from performing legal work (Bloomfield, 1988, p.41).

In another parallel with the experience of accountants, the legal profession was hindered by divisions along class and ethnic lines. The profession's leadership consisted of white, Anglo-Saxon men, and these men were determined to keep it that way. But as African-American, women, and Jewish lawyers began to organize societies and compete for work, the legal profession was forced to take steps to unify the profession under one banner (Bloomfield, p.41).

One striking difference between the development of the American accounting and legal professions is the more broad-minded mentality of legal education in the United States. Beginning in the 1920s and New Deal years, a movement began in law school curricula to explicitly educate lawyers in the social implications and responsibilities of their work. The idealistic view of government's power to defend the rights of labor and minorities spurred a generation of law school students to take a more expansive view of their profession's role in American society. This tradition continues today in "the New Professionalism of today's public interest lawyers, consumer advocates, and poverty lawyers" (Bloomfield, 1988, p.46).

Accounting education, at least in the United States, consistently spurned this role and has arguably become even more focused today on educating accountants as financial technicians. Since the advent of positive economics in the 1950s, a movement begun with the work of Milton Friedman, normative research in accounting has been discouraged by the leading journals and universities. Lipartito and Miranti (1998) note: "Still others have noted how regnant methodologies and research paradigms have stultified the development of scholarly interest in the social dimensions of accounting"

(p.303). Notably, this is not true of accounting research abroad, where fields such as accounting history flourish.

The history of the American medical profession is also instructive. The Jacksonian era's distrust of institutions and privilege damaged doctors' reputations as well, but medicine further suffered from the fact that in this era practices such as bleeding patients made doctors of dubious utility. In this atmosphere, rival professions such as homeopaths proliferated. The American Medical Association was founded in 1847 as an organization of elite, upper-class practitioners that, like accounting's elite in the 1920s, disdained advertising and the vast majority of practitioners of all stripes. But rival groups flourished, and in the mid-nineteenth century most of the laws restricting the practice of medicine were repealed. The AMA continued to fight to retain some jurisdiction, battling nurses and pharmacists to hold on to an exclusive right to practice medicine (Numbers, 1988, p.60). Again they found strength in numbers, when in 1903 the AMA "took additional steps toward unity by...welcoming as members eclectics and homeopaths willing to forsake sectarian dogma for scientific truth (Numbers, 1988, p.63)." But as scientific advances broadened the field of medicine, doctors found that there were limits to medicine's ability to obtain an exclusive franchise. Instead, they conceded territory to psychology, optometry, dentistry, and a host of other specialties. This is somewhat like the truce accountants and securities lawyers reached to divide financial gatekeeper functions, or the never-ending battle between tax accountants and lawyers over that lucrative field.

What follows are four narrative chapters describing the evolution of the American accounting profession, followed by my conclusions. I hope to demonstrate how and why financial accounting and auditing became an essential cog in the functioning of American capital markets. Chapter II begins with the earliest roots of accounting and the development of public accountancy, tracing the British origins of the American profession and the profession's development in the United States up to 1927. Chapter III involves the crucial years of the stock market crash and the New Deal, with particular attention to the Securities Acts that created the paradigm for the modern accounting profession. Chapter IV describes the first decade of the SEC regime, and how the leadership and goals of the national organization of CPAs, the American Institute of Accountants, passed to a new generation eager to prove the accountant's utility to the American economy and society. Finally, Chapter V looks at the union corruption scandals and the AIA's (by this time renamed the American Institute of Certified Public Accountants) response. This episode, and the AICPA's new public relations efforts that began in these years, demonstrate how dramatically the profession's image of itself had changed from 1927.

CHAPTER II

ACCOUNTANCY TO 1927

This chapter will look at the evolution of accounting and auditing up to the era that my dissertation covers. This will set the stage for the rest of my study by describing where the profession stood in 1927. But I hope also to suggest the uncertain role public accountancy plays in a market economy. Capital markets evolved in the United States without broad requirements that the financial statements of publicly traded corporations be audited. The American profession has carved out its jurisdiction without ever offering clear evidence that the American economy benefits from its service.

I. Accounting Before the Industrial Revolution

Some form of systematic record keeping of financial transactions no doubt emerged as soon as society developed the concepts of money and writing. Even the most rudimentary business requires documentation of exchanges. The first exposition of double-entry bookkeeping is generally credited to Luca Pacioli in Venice in 1494, in *Summa de Aritmetica*. Most likely Pacioli did not invent double-entry himself, but historians have sufficiently traced the popularity of *Summa* to credit Pacioli as the father of accounting. Both Max Weber and Werner Sombart, writing in the early twentieth century, expounded on the importance of double-entry, Sombart writing: “Capitalism, without double-entry bookkeeping is simply inconceivable” (Sombart, *Der Moderne Kapitalismus*, 1919, quoted in Davidson and Anderson, 1987, p.112). The need for double-entry itself may be debatable, but Sombart’s point was that a commercial economy cannot function without some means of recording that identifies profit and

loss. Double-entry allows the proprietor of some good or service to track both the source and the use of his capital. When he loans out money, he can record that he is owed this money back and that he no longer has the cash available for his own use. When he purchases goods needed to run his business, he knows that he has replaced one asset (cash) for another (the goods he bought). It is no coincidence that Pacioli's work emerged from one of the first commercial societies, the merchant economy of the Italian city-states.

This ability to follow the flow of money through the business is an essential part of stewardship of funds, the fundamental element of investment. Investment requires trust; passive investment, where the investor takes no active part in the business, doubly so. That is why merchants prior to the nineteenth century tended to rely on family members, often setting up their sons and brothers in key ports. But without these personal connections, an investor will generally require some formal means of ensuring that his money is well spent. The Italian merchant of Pacioli's time made his living by funding overseas voyages to obtain raw materials or handcrafts that could then be sold in Europe. The money for these expeditions was obtained from other merchants or wealthy individuals. It was to keep track of these investments and the resultant profits that accounting developed. As Littleton writes: "Bookkeeping arose as the direct result of the establishment of partnerships on a large scale" (Littleton, 1933, p.9).

Accounting through the sixteenth century remained rudimentary, as did the nature of business. Goods were generally bought and sold with little value-added manufacturing taking place. Most partnerships were organized for a single voyage. The

partnership would then be liquidated, returning the capital and distributing the profits to the partners. Sophisticated bookkeeping was unnecessary for such ventures. In fact, a single-entry system that simply tallied each partner's investment and then distributed profits in proportion to the investment would likely have sufficed.

Some concept of auditing seems to be as old as bookkeeping itself. References exist from the Middle Ages of inspection being conducted of the books of town treasurers and chamberlains. Usually this was done by some other government official, although scattered evidence exists of professional auditors. A tombstone in Buckinghamshire, England reads: "Here lyeth part of Richard Bowle, who faithfully served diverse great lords as auditor on earth, but also prepared himself to give up his account to the Lord in heaven...He died on 16th December 1626, and of his age, 77" (Littleton, 1933, p.261).

Beginning in the early seventeenth century and continuing for about 200 years, most of the innovations in accounting occurred in Britain, as British overseas exploration and trade expanded and the British economy began an era of remarkable growth. Separated from the rest of Europe by the English Channel, the British economy was able to develop without the crippling costs of constant war that burdened its Continental neighbors. With a much smaller aristocracy than the rest of Europe, England's middling classes were far larger, making for a much broader consumer market that further fueled economic growth.

The scale of the British merchant's business expanded as the English economy grew. From 1600-1620, about 40 trading companies were founded in England with

approximately 10,000 investors (Harris, 2000, p.45). As overseas trade became more reliably profitable, more investors were needed, and sophisticated bookkeeping was in greater demand. As accounting practice developed sufficiently to satisfy investors' demands for careful stewardship of their funds, investors became increasingly willing to leave their investment in the business for the long term, no longer demanding that profits be divided at the end of every voyage. Overseas trade was increasingly dominated by going concerns, a business that runs for the foreseeable future with no plans to shut down. These businesses also functioned under unlimited liability, where the partners were expected to make additional investments as needed (Baskin, 1988, p.201). Keeping track of each partner's investment and profits became an increasingly complex affair. This work was generally done by the managing partners, who had been trained by apprenticeship or by reading one of the many primers on double-entry that had cropped up in the years since Pacioli.

Jonathan Baskin has described the historical evolution of investment as a process of developing tools to overcome what economists call asymmetric information, when one individual (the insider who runs the business) has more information than the passive investor. "Asymmetric information...appears always to have limited the scope and use of financial markets; the practices and institutions observable today represent solutions that have evolved to overcome these limitations...Only as public accounting data improved and as other signaling mechanisms evolved could security markets gradually progress from personal to arm's lengths transactions" (Baskin, 1988, pp. 200-1). As we will see, the need for proper accounting and auditing methodology has

throughout modern history been one of the pillars in developing markets for investment. As the sophistication of business and investment expanded from the rise of Britain's fiscal-military state through the Industrial Revolution, the practice of accounting evolved to the point where a profession of trained practitioners could find a place in the market economy.

II. The British Fiscal-Military State

The emergence of parliamentary government in Britain was crucial to the development of the accounting profession. British society evolved with a healthy skepticism of governmental authority, a tradition that distinguishes it from its European neighbors and that their American cousins would inherit. It was in this atmosphere that accounting came to be a crucial element of checks and balances on executive authority, in both public and private spheres of power.

This tradition emerged uniquely in England, for reasons historians continue to debate. Most popular is the "England is an island" thesis, that Britain's separation from Continental Europe left it less burdened by the costs of constant war than its neighbors, and delayed the development of a fiscal-military state that accrued power in a strong King. By the time England did develop into a military power, in response to France's Louis XIV in the late 17th century, a strong Parliament that zealously worked to limit royal power was already firmly entrenched.

Laurence Stone, in *Causes of the English Revolution* (1972), identifies Henry VIII's break with the Roman Catholic Church in 1534 as the seminal event in this evolution. Without the legitimacy the Church had provided to the English throne, Henry

and his successors were forced to accept increased parliamentary authority. His subsequent decision to sell off the extensive Church land holdings left the English Crown without a key source of revenue, forcing it to regularly go hat in hand to Parliament. These tensions were exacerbated by the high-handed rule of Charles I that culminated in the English Civil War (1642-51). With the restoration of the monarchy after Cromwell's dictatorship, an uneasy truce with King James II began. But suspicious of James' Catholic allegiances, members of Parliament conspired to oust James and install the Protestant William of Orange, who wished to enlist England alongside his native Dutch Republic in the struggle against Louis XIV. But in return for their support, Parliament demanded a substantive role in policy-making. A century and a half of struggle with the monarchy had left the English gentry with an independence and taste for power that profoundly shaped English politics. As John Brewer writes: "The presence after 1688 of a standing House of Commons eager to root out malfeasance and reluctant to disburse monies without good reason created a degree of public accountability that acted as a powerful constraint on administrative practice" (Brewer, 1988, p.70).

A strong national government with adequate funding was needed to enter the fray against Louis XIV. The rise of a fiscal-military state in England meant the rise of a political structure far more accountable to taxpayers (mostly the wealthy elite) than any of its European counterparts. As John Brewer writes: "The timing of the emergence of the English fiscal-military state is crucial. When its mobilization occurred, it happened under the auspices of a regime which exploited the techniques of Dutch finance"

(Brewer, 1988, p.24). These techniques included the creation of the Bank of England in 1694. Among the financial innovations of this era was the use of fractional reserves by banks (where only a percentage of the depositor's money is kept in the bank's vault, the rest being made available to loan out at interest, allowing the effective supply of money to exceed the actual amount of specie in circulation), but even more important was the creation of a broad investor class of wealthy individuals placing funds in the bank. The funds of the Bank of England and rival ventures like the notorious South Sea Company (whose stock collapsed in 1720) were used to fund the English military. The gentry of England now had a direct financial stake in how their government was run, and with the power of a standing Parliament, they increasingly demanded reliable information.

The actual practice of public accountability evolved slowly over the course of the 18th century. It was at this time (1693) that Parliament began guaranteeing government debt. Prior to the Glorious Revolution, the King borrowed on his personal responsibility alone. Britain developed a modern stock market after 1688 that facilitated broad investment by the public in government bonds and the East India Company. Reliable payments of interest on the bonds encouraged a public confidence in these investments that nations on the Continent could not achieve. With this credibility, England's fiscal-military state largely avoided the corruption that plagued France. Devastating as the stock market collapse that accompanied the South Sea Bubble of 1720 was, it did not damage the fundamental confidence of Britons in either their government or the private-public institutions (the Bank of England, the East India Company, and the South Sea

Company, which somehow survived the collapse of its stock) that remained its largest creditors.

The accountability of the British government in this era was perhaps best demonstrated by the immediate reaction to the South Sea Bubble. Richard Dale writes: “The subsequent crisis management did much to redeem Parliament’s reputation” (Richard Dale, 2004, p.148). Sir Robert Walpole used the collapse to gain ascendancy in the Cabinet over his Tory rivals. But regardless of his motives, his actions in the wake of the Bubble were of incalculable value to the endurance of the fiscal military state. As a biographer wrote in 1800: “Walpole now possessed the power, had he possessed the inclination, to ruin the South Sea company, the directors of which had treated him with many marks of contempt and obloquy” (Coxe, William, 1800, p.239). But instead the plan that he and others implemented, which would become the 1721 Act to Restore the Public Credit, preserved the Company and with it the financial edifice of the state. Seven million pounds owed to the government by the South Sea Company was forgiven, and investors who had made down payments on South Sea stock were permitted not to pay the balance. This was “an unprecedented intervention by the state” (Dale, 2004, p.147). A subsequent investigation by Parliament publicly exposed the fraud and widespread bribery involved in promoting the South Sea scheme, and several directors of the Company had their estates forfeited; one spent time in the Tower of London (Dale, 2004, p.150).

There is a basis for concluding that the Act to Restore the Public Credit was motivated by genuine sympathy for the thousands who had lost their savings as well as

an understanding of the importance of public confidence in the government and in British capital markets. Although this did inaugurate the notorious era of government corruption known as the robinocracy, Britain showed a sense of public accountability that stands in sharp contrast to their European rivals.

In addition to capital markets considered remarkably transparent for their time, a large and professional tax collecting bureaucracy also evolved in Britain in this era. These agents were generally trained in basic bookkeeping and statistics, and developed the art of paper trails for government funds. “Controversy over any tax measure of the British Parliament was invariably accompanied by the presentation of accounts, reports and papers in the lower house” (Brewer, 1989, p.130).

These practices took on greater significance in the late 18th century. The East India Company took over the province of Bengal in 1763, and soon had an army of 200,000 soldiers defending it. The stock of this semi-public institution was held by an ever-expanding investor class in Britain, and drew increasing attention from Parliament. In addition, the American Revolution, the first war the British Empire lost, was a cause of much soul-searching. A debate over the power wielded by British government led to “a growing appetite for data and information” supplied not only to Parliament but to newspapers and special-interest groups lobbying for government funds and favor (Brewer, 1989, p.221). The formal reports prepared by the bureaucracy had to be accessible to laymen, as the British citizenry developed an expectation that their government belonged to them.

Private investment also flourished in these years. Britons witnessed a transportation revolution in the late 18th century, and an expanding canal network also saw a flood of new investment, with canals often funded by hundreds of limited partners (Harris, 2000, pp.100,142).

But the art of accounting remained fairly static before the Industrial Revolution. Most of these businesses were family firms or partnerships, and there was still limited value-added manufacturing that required sophisticated cost-tracking. Even the vast government and public-private companies involved little more than record-keeping of investment and loans. While the principles of stewardship and transparency evolved from the 18th century, it would take the emergence of large-scale industrial enterprises to motivate innovations in accountancy.

III. Financial Reporting in the Industrial Revolution

In both England and the United States, canals were the largest and most complex enterprises before the age of factories and railroads. England's canal boom occurred in the mid to late 18th century. America, with its vast natural resources, was generally about a generation behind the British in industrial development, and its first major canal project was the Erie Canal, opened to traffic in 1823. It is therefore instructive to look in more detail at the canal builders' use of financial reporting and capital markets.

We have seen that England achieved a broad investor class through its major public-private corporations, the Bank of England, the South Sea Company, and the East India Company. But these entities were backed and overseen by the British government. Canals in England were generally private investments, and in the United

States the young government was only just beginning to establish itself as creditworthy. Enticing large groups of passive investors was an uphill battle. For this reason, “until the 1840s, even in England, canal and railroad securities were sold primarily in local markets” (Baskin, 1988, p.211). Residents of the region where the canal or railroad was being built were in a position to judge the project’s feasibility. Distant investors, in fact, would often rely on the depth of locals’ subscription to a stock to evaluate its prospects (Chandler, 1956, p.100).

The Erie Canal was a project on a scale that dwarfed any other canal in the world. It would link the farms of the Midwest with the port of New York City through a 300 mile path over upstate New York. Private capital markets in the U.S. were not up to the task of funding this immense project. As with Britain’s “Big 3” public-private companies, only government possessed the resources and credibility to undertake projects on this scale. The American federal government also proved reluctant to invest in “internal improvements”, and so the job fell to the state of New York. Hundreds of Americans from all walks of life purchased the bonds of the Erie Canal, but there was simply not enough capital in the young nation to fund its growth, and so a majority of the funding came from overseas investors, mostly British. To them, the United States represented an emerging market akin to China and India today. British investors in the early 19th century were the inheritors of a long tradition of careful stewardship and detailed reporting on their investments, and so it was in part to meet these expectations that the New York Canal Commissioners annually published detailed statements that are

among the earliest examples of financial reporting in the U.S. (Michael, 1996, p.4).

My own study of these statements forms the basis of the following discussion.

Characteristically for this era, the New York Canal Commissioners' statements consist mostly of engineering data, not financial statements. The incredibly detailed and sophisticated presentation of engineering issues were unlike anything an investor today would expect to see. Likewise, the financial data suggests a standard of stewardship unthinkable from modern management. Expenditures are often listed by the commissioner or superintendent responsible for them, with exact dollar amounts for what was spent under each supervisor's authorization. In one instance, a three page estimate of the cost of building an aqueduct with a wood trunk is followed by a three page estimate of the cost of building the same aqueduct of stone. These were the kinds of disclosures that would assuage jittery investors. As New York Governor Clinton wrote: "[Employ] able engineers and skilled contractors, [because, as he maintained, only] an undertaking conducted under such auspices will propitiate public opinion and secure the confidence of capitalists who are disposed to embark their funds in the enterprise" (Miller, 1962, p.92).

Two insights can be drawn from this emphasis on engineering over finances. The first is that a tradition of disclosure and accountability far outpaced the development of accounting. Stewards of other people's money felt obliged to demonstrate that their work was careful and conscientious. But it did not necessarily follow that sophisticated accounting practices were the best means of conveying this. More logical to the corporate managers of this era was to show the tangible results of their projects, rather

than the profits accruing to the investors. This may be seen as a reflection of the attitude towards investment in the age before the Robber Barons: the goal of business enterprise was the public good, with profits to the investors an ancillary benefit (Baskin, 1988, p.208).

Second is that a tradition, antiquated though it may have been by this time, endured that investors took an active role in the business, and possessed both the time and the inclination to make themselves fluent in the field they invested in. As we have seen, increasingly in this era capital markets were expanding to the point where the passive investor, who knew little of the business beyond a hope for its profitability, was the norm (Michael, 1996, p.22).

Even for the simple financial data that does appear, there is a lack of consistency in how it is presented. Different tables are shown in different formats from year to year, and amounts are rarely tied to the previous year's statements. This is perhaps the strongest evidence of the fledgling state of accounting, and suggests that the preparers of these reports learned by doing. Finally, there is little evolution in the sophistication of the accounting over time, implying that the New York Canal Commissioners did not consider financial data important enough to incorporate best practices or to make changes demanded by investors (assuming there were any).

IV. The Birth of the Accounting Profession

In the late 18th century, business enterprise, while expanding tremendously, had seen little qualitative change since the Renaissance. The work of a businessman was not much different in England or America in 1800 than in the Italian city-states in 1500.

“Business” still consisted largely of the buying and selling of goods, with little value-added production. The general merchant purchased and sold whatever goods he could acquire wherever he could find a market. There was little capital investment beyond the ships and wagons needed to transport goods. And so there was little need for sophisticated accounting methodology. Businessmen like Josiah Wedgwood generally did not employ trained accountants (of which few existed.) They often improvised their own rudimentary, though detailed, recordkeeping systems (Jones, 1981, p. 25).

Two innovations would revolutionize both business and accounting. Mechanization made business more complex, and the separation of ownership and control transformed how it was financed. The first was the series of inventions that geometrically increased the scale of production. As T.S. Ashton described it: “A wave of gadgets swept over England” (Ashton, 1948, p.3). Goods that had formerly been crafted individually by skilled artisans could now be produced in greater quantities and at lower unit costs. But these machines and the factories to house them required huge capital investments. Such sums could only be raised through numerous investors, most of whom had little knowledge of or interest in how the business was run. New methods would be needed to track costs and to steward investors’ money.

The concept of limited liability had existed for centuries, but only became commonplace in the 19th century. In a partnership, investors were expected to contribute additional funds when the business ran short of cash, and were liable for any debts the business accumulated (This was generally not as onerous an obligation as it might seem, since most businesses in the pre-industrial era carried little debt and were

financed almost entirely from partners' equity). But for the small scale, passive investor, the prospect of unlimited liability was too risky. The corporate form of business offers the limited liability necessary to attract widespread investment, but had been outlawed in England since the South Sea Bubble in 1720. Incorporation could only be obtained through act of Parliament, and was rarely granted. Limited liability would only become the common form of business organization in the 19th century. Further, unlike overseas voyages to obtain goods or the building of canals, large scale industrial enterprises are generally going concerns. This made it necessary to keep the invested capital in the business, with only profits paid out to the owners. Careful accounting that distinguished capital from profit and kept track of each owner's investment became essential for the corporate form to thrive.

After some 300 static years, accounting rose to meet the challenges of the Industrial Era. The presentation of detailed engineering data was abandoned in favor of financial data that allowed the passive shareholder to calculate his profit rather than keep careful tabs on the running of the business. A small shareholder without access to management needed to know the number of shares outstanding and the book value of the firm in order to assess the value of his investment. The British Joint Stock Companies Act of 1844 mandated that corporations annually publish a balance sheet, making the use of accrual accounting essential in order to tabulate the company's revenues and expenses at a point in time, as opposed to cash accounting that necessitated waiting for cash to change hands before the outcome of transactions could be determined.

The increased use of heavy machinery required new accounting methods to allocate costs over time. It was the railroads that pioneered in this area. The cost of equipment that would benefit the business over the course of decades could not all be charged to one year without greatly distorting the presentation of the firm's profitability. Depreciation accounting allows for the equipment to be charged in increments as expenses every period throughout its useful life.

The Industrial Revolution came to Britain about a generation ahead of America, and so it is no surprise that the British pioneered in financial reporting practices and that Americans largely followed British practice. With the 1844 Act, Britain finally recognized the need for corporate organization of business, ending the practice of a new corporation requiring a special act of Parliament. The 1844 Act further mandated that auditors be hired to represent the shareholders' interests. From the beginning, it was understood as fundamental to the new scale of business that accounting and auditing serve to protect shareholders (Littleton, 1933, p.289-93).

With the increased complexity and demand for accounting services, we begin to see the emergence of an accounting profession. Historians emphasize that the one did not necessarily follow the other. The original intent of the British statutes was that a few shareholders would be elected to audit the company's books, not that trained professional auditors would be used. As John Carey writes: "Economic and social change created the *need* for an accounting profession – but accountants themselves *created* the profession by constantly raising their standards of performance" (Carey, 1969, p.4). In 1854, the Society of Accountants in Edinburgh was formed, apparently

the first organization of professional accountants (Carey, 1969, p.19). It was also in these years that the first audit firms, including Deloitte and Price Waterhouse, were founded (Jones, 1981, p.32). In the United States, no statutory requirements for independent audits were passed until the 20th century, and the American profession would be generations behind the British, as we will see.

According to Littleton, it was the increasing frequency of bankruptcy in the boom-and-bust economy of the 19th century that first created the demand for an accounting profession in Britain. Properly valuing the assets of a failed business and dividing them up among its creditors demanded an ability to decipher a company's records. This was work that could have been done by lawyers, but the nascent group of accounting professionals in England successfully carved out a jurisdictional space. It was to earn the public's trust and convince them of the necessity of their expert knowledge that the first professional societies and educational requirements for accountants emerged in the mid-19th century. This was often an uphill battle, as the statement of one judge in 1875 suggests: "The whole affairs of bankruptcy have been handed over to an ignorant set of men called accountants" (Littleton, 1933, p.283). But by the late 19th century, accounting was a recognized profession in Britain and was ready to export itself to America.

V. The Accounting Profession in America

America's abundance of national resources and relative scarcity of capital and labor meant that it remained an agrarian society through the early 19th century. This began to change with the War of 1812, when the cutoff from British manufactured goods

spurred the U.S. to begin developing its own manufacturing base. Beginning with the Erie Canal in 1823 and the expansion of an American railroad network in the 1840s, large scale business, largely funded by European (particularly British) investors, spurred the growth of American capital markets. As business became more large-scale and the separation of management from ownership became more ubiquitous, formal reporting by firms came to replace personal relationships as the basis for establishing trust between investors and proprietors. Over the course of the 19th century, the burgeoning American economy became an increasingly popular investment. It was British investors who first sent over professional chartered accountants to shepherd their investments and report on the soundness of American business. From these origins, American accounting would develop emulating the British model, centered on professional accountants governed by broad statutes, rather than a large government bureaucracy.

In fact, America's initial response to the growth of industrial size and power was much closer to the model of Continental Europe. The era of the Robber Barons, when big business emerged in the United States leaving a handful of managers with unprecedented and largely unchecked power over the American economy, led to increasing calls for regulation of business. As Thomas McCraw describes, "A serious institutional lag had opened up between corporate development and the public response to it" (McCraw, 1984, p.8). McCraw explains in *Prophets of Regulation* how the independent regulatory commission served as the Progressive movement's initial response to bringing oversight to the nation's first big business, the railroads. With the creation of the ICC and its requirement of standardized accounting data by railroads in

1886, American public policy was well along a path of government dictating and disseminating corporate disclosures. Paul Miranti concludes: “Public accountancy was not a well-known profession to many government leaders; many of them, instead, preferred alternative models of economic regulation that depended on the operation of strong bureaucratic agencies rather than independent professional groups such as accountants” (Miranti, 1990, p.26). Into the 20th century, accountants in the United States had no statutory mandate and no public profile to become the watchdogs of big business.

The creation of a public accounting profession in the United States along the British model was largely the work of the transplanted British accountants. The British firm Price Waterhouse opened a New York office in 1890. The first national organization of accountants was the American Association of Public Accountants, formed in 1886 by a handful of American and British practitioners. Their goal was to pave the way for their large firms to expand nationally, and so they fought to create standardized licensing requirements in the various states. They were hindered in this effort because they did not represent the growing population of local practitioners, who obtained their licenses through the states and saw little benefit to a national organization.

The influence of British practices on the development of the American public accounting profession stands in stark contrast to the evolution of cost accounting in America. Because of the size of the American market, American big business, starting with the railroads and continuing into the first giant manufacturing enterprises started by men like Andrew Carnegie, grew to a scale that dwarfed anything in Britain. For this

reason, along with a cultural stubbornness described by David Landes in *Unbound Prometheus* and Alfred Chandler in *Scale and Scope*, American managerial techniques were far more innovative than their British counterparts. This included the field of cost accounting, which was pioneered, first by engineers and then by trained accountants, in the United States and then copied by European firms.

Miranti emphasizes the cultural cleavages that separated the elite American accountants who wished to emulate the British model from the mass of local practitioners. The elite accountants, like much of upper-class America in the late 19th century, were anxious about the growing influence of the newer immigrant groups from Southern and Eastern Europe. Following an Anglo-Saxon model in the development of an accounting profession would serve to solidify their place in American society. This agenda spread to ideas about the proper training of public accountants. The British model continued to be centered on an apprenticeship system, something the elite hoped to transfer to the U.S. “Apprenticeship was not a practice these [local practitioner] members wished to see adopted in America. Instead, educational institutions accessible to all who had ability were more appealing to those whose advancement in the old world had been retarded because of humble origins” (Miranti, 1990, p.42).

The Progressive movement spawned a host of new government regulation of business, and created both an opportunity and a challenge to the fledgling American accounting profession. The elite accountants in particular worried that excessive government mandate of reporting requirements would reduce accountants to mere technicians. But they were also able to extol the role accounting could play in a society

that emphasized scientific methods and technical education as the solution to a system many Americans saw as corrupted by an alliance between big business and government.

Despite some gains by accountants in carving out a space for themselves in the American economy, Progressivism's emphasis on government regulation continued to push public accounting more towards a Continental model. But the sedulous work of the transplanted British accountants, along with the basic anti-statist bias that remained ingrained in American ideology, reversed this trend and set a course towards an independent accounting profession, rather than government bureaucracy, as the watchdogs of American business that would finally be enshrined with the New Deal. This trend began with a scandal in the insurance industry in New York in 1905. To clean up the industry in the wake of revelations of financial improprieties, the large public accounting firms were called on to audit the companies. Next, a consensus began to form that the data collected by the ICC was often inconsistent and unreliable. Although the Hepburn Act of 1906 attempted to correct these deficiencies, the idea of independent accountants preparing and verifying business disclosures became increasingly attractive. The enactment of a federal excise tax in 1911 and the federal income tax in 1913 also swelled the ranks of accountants in the U.S. and gave the profession a more powerful voice.

But it was the government's mobilization efforts in World War I that cemented public accounting's place in American society. "America's entry into war changed the relationship between the profession and the federal government" (Miranti, 1990, p.103). The government quickly discovered that its bureaucracy was woefully inadequate to the

needs of a wartime economy, and the alliance that formed between business and government proved a boon to accountants. Several American practitioners, including George O. May, took prominent places on the War Industries Board that greatly enhanced the profession's reputation and prestige. Investment in government war bonds, the so-called Liberty Loans, are credited with introducing passive securities investment to a broad swath of the American public, a trend that had begun during the merger movement of the 1890's and would greatly expand in the 1920's (Navin and Sears, 1955, p.105).

Louis Brandeis' *Other People's Money and How the Bankers Use It* was a collection of nine articles Brandeis had written beginning in 1913. "More than any other document of the Progressive Era, *Other People's Money* captured the anger that reformers felt about monopoly and their fears about what bigness could do to American democracy" (Urofsky in Brandeis, 1995, p.28). Brandeis does not stress financial accounting as a means of regulation of big business, but in other writings he "counseled the [Wilson] administration to require industry to provide it" (Miranti, 1990, p.108).

Financial statement audits became common among American big businesses in the years 1917-27. This began with a 1917 memorandum issued by the American Institute of Accountants at the urging of the Federal Reserve Board and Federal Trade Commission. "Uniform Accounting", written under the direction of George O. May, was the first formal guidance in the United States on proper audit procedure, and reflected the government's new respect for the profession (Hawkins, 1963, p.155, Zeff, 2003a, p.191). However, the new stringency the memorandum encouraged was not

easily disseminated into corporate practice. “Despite their prestigious backers, the recommendations outlined in *Uniform Accounting* were not quickly adopted by corporations, bankers, or the accounting profession – chiefly, because bankers, out of a fear of driving away customers, refrained from insisting upon audited statements from their clients” (Hawkins, 1963, p.156). As of 1927, public accountancy possessed neither the stature nor the professional unity to serve as effective financial gatekeepers. But demands that it become so were only just beginning to be heard.

CHAPTER III

THE CRASH AND THE NEW DEAL, 1927-1934

The role of the auditor in giving a seal of approval to corporate financial statements is something we take for granted today. But as we saw in Chapter II, financial accounting did not play a central role in the development of American capital markets. The CPA's contribution as financial gatekeeper was largely defined in the years 1927-34. It began with the publication of William Z. Ripley's *Main Street and Wall Street*, which urged accountants to assert their independence from corporate management and assist in the development of transparency in corporate communications with investors, and ended with the creation of the Securities and Exchange Commission, a government agency that came to see the development of the accounting profession as one of its most important missions. The crisis of the Great Depression led Americans to consider radical solutions, but their anti-statist bias was still too well ingrained to seriously contemplate a government takeover of corporate auditing. Instead they placed the responsibility of corporate watchdog on an accounting profession unprepared to handle it. Over the remainder of the decade, the newly created Securities and Exchange Commission regularly threatened to wrest control of accounting standards away from the profession, until finally the humiliating McKesson-Robbins scandal made clear that public accounting had not achieved the standards of professionalism that the American regulatory system demanded of it. But thrust into the public spotlight by Ripley, by the stock market crash of 1929, by the revelations of the Pecora congressional hearings, and

by the seminal reforms of the New Deal, public accounting began the process of molding itself into the profession it needed to be.

I. Early Calls for Reform

In 1922, the NYSE required all companies listed on its exchange to publish financial statements, although there was no requirement that they be audited (Carey, 1969, p.158). By 1923, more than 14 million Americans had money in the stock market. The so-called Blue Sky Laws, the uneven state regulations regarding the marketing of securities, were the only laws governing the sale of stock, and exact authority over the market for shares in the huge industrial enterprises Americans were investing in was unclear. As Louis Brandeis had written, who should keep an eye on *Other People's Money*? Should regulation be conducted by the stock exchanges such as the NYSE, the federal government, or the individual states? Exactly what role did audited financial statements play in this regulation?

The most influential writing on this subject was a series of articles that appeared in Atlantic Monthly in 1926, published in book form as *Main Street and Wall Street* in 1927 by an economics professor named William Z. Ripley. The influence of Ripley's writings has been noted by several historians. In fact, the best known writing on market regulation and corporate governance of this era, Berle and Means *The Modern Corporation and Private Property*, acknowledges a debt to Ripley in its preface. It is also noted by John Carey in his official history of the AICPA. And perhaps most importantly, Ripley's writings stirred George O. May to action, as will be discussed below.

Main Street and Wall Street inherits the Progressive tradition of Louis Brandeis.

Ripley sees the small shareholder as analogous to the citizen of a democracy: both needed organized interests to protect them from big business. His often overwrought rhetoric puts him squarely in the Progressive tradition: “The institution of private property, underlying our whole civilization, is threatened at the root unless we take heed” (Ripley, 1927, p.83). As he surveys the regulatory means available, he finds the existing state of affairs unequal to the task. The Blue Sky laws had resulted only in “the scandalous prostitution of the sovereign power of the states” as states compete in a race to the bottom of regulatory enforcement to encourage business (Ripley, 1927, p.28). He advocates public disclosure of information as the only realistic solution: “No other safeguard against misuse of power by insiders is so likely to be effective as publicity. Nothing kills bacteria like sunlight” (Ripley, 1927, p.109). Ripley does not trust big business to publish reliable information on its own: “How averse will any one of them be to adopt a policy of disclosure until it becomes generally recognized as ‘good business’ to do so...the laggard corporation, persistent in secretiveness, lays a heavy penalty upon its rivals all down the line” (Ripley, 1927, pp.208,9). He concludes that federal government regulation is needed for enforcement of disclosure requirements, writing “there are already at Washington three agencies which may conceivably become involved in these matters”(Ripley, 1927, p.114).

And what role will accountants play in this new system? Like Berle and Means in their classic *Private Property and the Modern Corporation*, we can see in Ripley a view that financial accounting is central to the proper functioning of a capital market.

This conclusion had been evolving in capital markets for decades, but the vital role Ripley and Berle and Means give to accounting marks a clear sea change. Prior to their writings and the legislative reforms of the New Deal, “the influence of accountants remained small...the concept of the outside ‘independent auditor’ had not yet come of age in the United States” (McCraw, 1984, p. 167-8). If for no other reason, the amount of space Ripley devotes in his writing to accounting and audit issues suggest the role he sees for accountants.

But his opinion of the profession itself is another matter. Ripley’s views of accounting are similar to many outside observers: bafflement at its technical minutia and suspicion of its practitioners’ allegiances. Ripley views CPAs as subservient to management, and despairs of CPAs fulfilling the essential role he sets for them without formal, legal recognition of the independent audit. He suggests “some permanent agency...[whose] primary function would have to do with adequate publicity through independent audit” (Ripley, 1927, pp.132-3). And after sampling a “great pile of corporate pamphlets, the first impression is of their extraordinary diversity, in appearance, size, content, and intent” (Ripley, 1927, p.162). He calls for standardized accounting rules to make financial statements more easily comparable, but is not confident that accountants, left to their own devices, will be able to agree on accounting standards.

Ripley was certainly right to question whether accounting was up to the task he had set for them. Even George May, by this time the most prominent accountant in the United States, doubted the profession’s readiness. He wrote in 1926: “There is not in the

profession as it now exists a body of men capable of dealing adequately with the problem...at the present time auditors hold office usually at the pleasure of the officers of the company” (May, 1936, pp.44,6). And Carman Blough, the first Chief Accountant of the Securities Exchange Commission, described the pre-New Deal profession this way: “Even through the first three decades of this century, professional public accounting made rather slow progress. Much of its work was more or less detailed checking for the satisfaction of management, with little attention to the interests of creditors and investors” (Blough in Cooper and Ijiri, eds., 1979, p.31). Warren Nissley, then a senior partner at Arthur Andersen, also “became deeply concerned about the inadequacies of the financial reporting practices which then prevailed and the apparent lack of independence on the part of certain accounting firms” (Higgins, 1965, p. 166). And finally there is the view of James Landis, author of the Securities Acts: “The impact of almost daily tilts with accountants, some of them called leaders in their profession, often leaves little doubt that their loyalties to management are stronger than their sense of responsibility to the investor. Such an experience does not lead readily to acquiescence in the plea recently made by one of the leaders of the accounting profession [no doubt referring to George May] that the form of statement can be less rigidly controlled and left more largely to professional responsibility alone. Simplicity and more adequate presentation is of course an end much to be desired, but a simplicity that misleads is not to be tolerated” (Higgins, 1965, p. 166).

For the most part, the accounting profession had so little sense of public opinion that it did not even take notice of *Main Street and Wall Street*. But the book did make

an impression on George O. May. May began his career in America in 1896, sent by the British firm of Price Waterhouse to study the American railroads Europeans so heavily invested in. He held a senior position on the War Productions Board during the First World War, as government turned to business to handle the tasks it did not have the bureaucracy to handle itself. And when Ripley's articles began appearing in *Atlantic Monthly* in 1926, May was one of the few accountants who saw the writing on the wall, and began to push for reforms of financial accounting and audit requirements.

May credits Ripley with bringing accounting issues to the attention of the investing public (May Papers, 57-6, 1960). He writes: "I have been in conference with economists and lawyers, and I have been struck by their insistence on the importance of accounting in the proper development of the corporate system" (May Papers 53-6, 1930). Again we see hints that the accounting profession's slow response to the calls for reform was rooted in their complete ignorance of the tenor of public opinion: they did not even appreciate how important their own profession had come to be seen.

Much like the muckrakers of a previous generation, Ripley's critiques often lack both sophistication and solutions. He warns of "inroads upon shareholders' rights" without describing what these rights should be or when they were ever practiced (Ripley, 1927, p.39). It is also not clear whether Ripley actually knew what he was talking about, at least in regard to accounting. Ripley himself freely confesses his ignorance of accounting issues, and George May certainly did not think much of Ripley's arguments (Ripley, 1927, p.198). In a letter to the *New York Times*, May carefully demolishes Ripley's criticisms of corporate financial statements, writing that his assessments of the

financial statements of Bethlehem Steel and National Cash Register are factually wrong and concluding: “It is...wholly unfortunate that Professor Ripley should in his enthusiasm for his objective have allowed himself to be betrayed into inaccuracy and injustice of statement”(May Papers, 63-12, 1926). May’s letter suggests that accountants’ inability to control the debate over reform of capital markets can at least partly be attributed to a failure in public relations. Ripley may not have understood the technical accounting issues he was criticizing, but his sweeping, seemingly learned arguments captured the public’s attention and thus controlled the debate. Ignorance of accounting issues is a charge May would level against most of his adversaries at the SEC over the coming decades.

II. George O. May’s Response to Ripley

The importance of the 1929 Crash in reforming the stock market has probably been exaggerated by historians. A simple timeline makes clear that the pressure for reform from writers such as Ripley predated the Crash, and important reforms were not actually implemented by private organizations until 1932 and by government until FDR’s administration. But if we take 1927 and the publication of *Main Street and Wall Street*, and not the Great Crash of 1929, as the seminal event behind the reform of American capital markets, we are still left with the question of why reform was so slow, and why the voluntary reforms of the NYSE and the accounting profession (below) were not enough to preempt federal intervention. The answer is simple enough: Wall Street, in which I include the elite of the accounting profession, was too narrow minded and isolated from the larger culture to appreciate the pull of public opinion: CPAs like

George O. May expected to be taken at their word that they were trustworthy, and viewed regulation as superfluous and probably as offensive. This is how the *Accounting Review*, the journal of accounting professors, described the American Institute of Accountants, the organization of elite, Wall Street accountants: “The Institute is the survival of another generation – a static, supremely self-satisfied organization” (“Corporate Accounts and Reports”, 1933, p.164). Unsatisfied with the AIA’s foot dragging in writing formal accounting principles, accounting professors under the leadership of *Accounting Review*’s editor, Eric Kohler, attempted to take the initiative themselves by publishing “A Tentative Statement of Accounting Principles Underlying Corporate Financial Statements” in 1936 (Zeff in Cooper and Ijiri, eds., 1979, p.8). This would be the central tension in the evolution of American accounting into a true profession. It is accepted today that a large-scale, industrial economy requires formal regulation in order to be ruled by laws and not men. Accounting would never achieve the status of a true, independent profession without recognizing this. Only when the profession was pulled away from the leadership of the Wall Street elite would it be ready to accept the role Ripley and the New Dealers envisioned for them. The battle over the next decade would be to formalize the practice of accounting through legal liability, the setting of accounting standards, the granting of an exclusive legal franchise to conduct financial statement audits, and most importantly the inclusion of all practicing accountants in a single professional body.

Accounting’s elite had selfish motives for obstructing any changes in the accounting profession, fearing that reform would legitimize a broader segment of the

profession. Edwin Perkins writes: “Reputable investment firms and the officials of leading stock exchanges did not advocate the passage of protective legislation because they relied on the uncertainties associated with over-the-counter markets to retain the allegiance of existing customers who were reluctant to invest in unlisted stocks” (Perkins, 1999, p.132). This story, applied to the accounting profession, has been told by Paul Miranti. Wall Street accountants like George May and represented by the American Institute of Accountants feared that increasing the reach of the accounting profession would mean allowing into the profession men of inferior background and training, by which they meant accountants from the Midwest, South and West who had gone to local colleges, worked for small, local firms, and often hailed from the newer immigrant groups from Southern and Eastern Europe. These men (and they were almost all men before World War II) constituted the vast majority of American CPAs and were represented by the rival organization to the AIA, the American Society of Certified Public Accountants. Giving these men a voice in the profession would threaten the elite’s comfortable place in the American business world. The elite had plenty of work auditing the largest American corporations, and no desire to rock the boat by demanding more independence from their clients: “Years of uninterrupted prosperity for the large national firms, with the control of the profession as a natural by-product of their growth, have built up a complacency and sense of security which are now being rudely shaken” (“Standards Must Come”, 1934, p.334).

But private reform achieved major advances in capital market regulation, and the eventual federal intervention would largely build on these reforms. Particularly on

accounting issues, the private reforms put in place before the New Deal were arguably of more importance than the Securities Acts themselves. Perhaps ironically, they were initiated by the doyen of the accounting elite, George May, in the hope of retaining the initiative in reform. *Audits of Corporate Accounts*, published in 1934 by the New York Stock Exchange, was the work of a committee of the American Institute of Accountants cooperating with the NYSE (American Institute of Accountants Special Committee on Cooperation with Stock Exchanges, 1934). Its chief author was George May. The 47-page pamphlet was written directly in response to Ripley's *Main Street and Wall Street*, and it was May's hope that "Audits" would head off the drive for federal legislation (Grady, ed. 1962, p.57). His efforts might have been successful were it not for the Pecora hearings and the election of FDR.

Audits of Corporate Accounts is arguably the most important single document in the history of American public accounting. It outlines the purposes and limitations May envisioned for the corporate audit. As May wrote to his chief contact and collaborator at the NYSE, J.M.B. Hoxsey: "The old forms of account were designed for proprietors familiar with the business. With ownership becoming widely distributed among persons unfamiliar with the business, and with substantial fractions of the ownership changing hands every year, it may well be that some radical change in the form of presentation is necessary"(Grady, ed., 1962, p.59). Contrary to what would be written by New Dealers and historians about accounting, May clearly understood the profession's chief obligation was to the small shareholder.

A need clearly existed to codify best practices in auditing and financial accounting. As one observer described it: “Some practicing accountants and a few teachers undertook to write books, but they simply took what they considered the best of what they had learned in practice and combined it with what they thought should be done and what they had seen in others’ writings. Some of these authors, whether due to lack of knowledge or intent to improve, often presented procedures they considered ideal and which in fact did not reflect then-current practice” (Blough in Cooper and Ijiri, eds., 1979, p.33).

The pamphlet lays out both the basic form financial statements should take (e.g. that previous years’ statements should be presented for comparison, and that the income statement should show separately operating income, extraordinary items, and income taxes) and sets the standard for all future regulation by coining the phrase “fairly general acceptance” which would later evolve into today’s well-known “generally accepted accounting principles” (American Institute of Accountants, 1932, p.12). May felt that allowing corporations to choose from a broad array of accounting practices was preferable to so-called “bright-line” accounting where specific rules are put in place for all financial statements to follow. This basic philosophy suggests one of the greatest tensions in the accounting profession for May and his generation. May generally was suspicious of the need for strict rules and regulations governing the actions of professionals like himself; he felt that their judgment and integrity were sufficient safeguards against abuse. This is why he resisted allowing accountants with less training than himself to join the profession (class and ethnic issues notwithstanding) and why he

found himself in conflict with the New Dealers: elite professionals of May's generation recoiled at the very thought that their judgment might be questioned. Formal rules of accounting and of auditing procedure were necessary only for those who lacked the training of the Wall Street elite. This is the central reason why the AIA opposed joining with the ASCPA: fear that poorly trained accountants would lower the standards of the profession. As May writes, referring to the ASCPA: "The raison d'être of these rival societies is largely an unwillingness to accept the Institute's standard of ethics" (May Papers 53-6, 1928). J.P. Morgan, Jr., in testimony before the Pecora Committee in 1933, states that bankers are subject to a code of ethics so exacting that "we have never been satisfied with simply keeping within the law" (Seligman, 1982, p.32). Similarly, when the President of the NYSSCPA, Colonel Arthur Carter, testified before Congress on the proposed Securities Act, the famous exchange that followed illustrates the generational and class chasm that separated the New Dealers from Wall Street in this era:

Sen. Barkley: You audit the controllers?

Col. Carter: Yes, the public accountant audits the controller's account.

Sen. Barkley: Who audits you?

Col. Carter: Our conscience. (United States Congress, 1933, p.58).

The limited accounting standards set in *Audits of Corporate Accounts* did not win universal acceptance within the profession, many of whom saw the need for a more expansive set of formalized rules. This was the reaction of the *Accounting Review*, the journal of accounting professors. It summarizes May's proposals this way: "Rather than impose rules devised 'by competent authority,' let each corporation 'choose its own

methods of accounting,' for the greatest value attaching to uniform accounts is the disclosure of method followed and the 'consistency of method which they tend to produce.' Mr. May states that the method of reporting earnings is unimportant to the investor provided the investor knows the method." They conclude: "But is disclosure without more than the meager standardization indicated a sufficient safeguard for the average investor? Mr. May vouchsafes no answer" ("Corporate Accounts and Reports", 1933, p.164). *Audits of Corporate Accounts* again betrays May's belief that professionals could be trusted to make the right judgment. A lack of uniformity in different companies' presentation of financial statements makes them less accessible to the reader, whether that reader is a trained accountant or not. This would be a point stressed by the New Deal reformers and later by the SEC, and the reluctance of May and the rest of the profession's elite to set detailed rules for financial statements would be a major source of tension in the battles to come.

III. The New Deal and the Securities Acts

Joel Seligman, in his study of the SEC, *The Transformation of Wall Street*, portrays the passage of the Securities Acts as a political response to the public outrage over the revelations of the Pecora hearings, which, among other things, described excessive executive salaries and the notorious fraud case of the Match King, Ivar Kruegar (see also Fleshman and Fleshman, 1987). But Seligman's conclusions draw too neat a line from the Crash to the Securities Acts; the push from writers like William Ripley had been building for years. George May himself would state in December of 1933: "No one who has watched closely the developments of the past 10 years can

wonder that a securities law should be enacted, or even be greatly surprised at the form it has taken” (Landis Papers, Box 12, 1933). But the accounting profession’s reaction does make clear just how politically clueless the profession was in this era. No less sympathetic a source than the AICPA’s official historian, John Carey, concludes: “Despite William Z. Ripley, despite Berle and Means, despite the Pecora investigation, despite public demand for reform of the securities markets, the Institute had made no effective preparation to deal with legislation directed to that end” (Carey, 1969, p.182). The *Accounting Review* similarly doubted the profession’s ability to rise to the challenge of the New Dealers: “A new day will dawn for the accountant, however weakly and fatuously he may resist its coming” (“Standards Must Come”, 1934, p.335). But the Securities Acts would prove to be an almost unmitigated triumph for accountants: they received the legitimacy they had long sought as an integral cog in capital markets, the power to set accounting standards themselves, and even, eventually, to limit their legal liability. How they accomplished this is a story that has puzzled several outstanding historians.

Not that the profession itself embraced the Securities Act of 1933. Without exception, it seems, they were particularly incensed by the legal liability it imposed on accountants. The Act held accountants liable for any “omission of material facts,” and allowed the auditor to be sued even if the plaintiff could not prove they had relied on the misstatement when purchasing the stock. The response from accountants was apoplectic: “The accounting officer as well as the independent public accountant see their public recognition greatly enhanced, but along with this welcome enhancement of

standing comes a burden of responsibility that is truly appalling. The risk assumed by an accountant-officer or by a professional accountant, who signs the registration statement submitted to the Securities Commission of the Federal Trade Commission is quite out of proportion to the possible material benefits that may be derived from the service rendered” (Weidenhammer, 1933, p.272). Robert Chatov, a lawyer and author of one of the best histories of the American accounting profession in the twentieth century, largely agrees that the liability provisions imposed by the 1933 Act were excessive, calling it “a major departure in American law:...the plaintiff no longer had to prove the guilt of the defendant, as traditionally required for civil liability in a negligence action” (Chatov, 1975, p.58).

Landis, in a brief history of the Securities Acts written in 1959, cites the English Companies Act as the model on which the American Securities Acts were based. But Seligman argues persuasively that the NYSE’s listing requirements, more detailed than the English Companies Act, were the true predecessor. This would suggest, as Carey in fact does, that May’s efforts with *Audit of Corporate Accounts* came just in time. By providing at least a basic outline of what regulation of financial statements might look like, *Audit of Corporate Accounts* may have prevented a wholesale rethinking by the federal government of accounting reports.

The 1933 Securities Act mandated financial statement audits for all publicly traded companies making initial stock issues. These were to be conducted by “public or certified public accountants.” It required the release of balance sheets and income statements for each of the previous three years. And it left the question of setting

accounting standards open. These provisions were obviously a tremendous boon to accountants, who with this grant of an exclusive legal franchise now had the independence from management they had long sought. What accountants did not care for were the Act's liability provisions. Accountants greatly feared the liabilities given them under the '33 Act, and were not shy about saying so. On more than one occasion, May obliquely threatened that accountants would refuse to engage in audits of public companies under this provision, a point no less an authority than William O. Douglas, later Chairman of the SEC, seemed to endorse: "It may be expected that the more reputable [accounting] firms will be more chary than ever of becoming experts for any but the more substantial issuers" (Douglas and Bates, 1933, p.171).

But part of the blame for the profession's hostility must also fall on James Landis, the chief author of the Securities Acts and the Roosevelt administration's chief spokesman on securities issues. One historian concluded that "in both the design and the early administration [of the SEC], the most influential person...[was Landis]" (McCraw, 1984, p.154). His wariness and even hostility towards accountants is suggested in his remarks before the New York State Society of CPA's in October of 1933: "Sometimes I have wondered whether you, just like the members of my profession, do not tend to make more mysterious your own knowledge so as to widen the gulf that separates you and us from the ordinary unsuspecting layman." He continues: "If half of the energy that has been expended in fulminating against the Act and propagandizing for amendments were enlisted in the effort to advise the Commission in the wise exercise of its powers, the government and issuers, bankers, lawyers and accountants would be far

nearer to a solution of their problems” (Landis papers, Box 12, 1933). But in fairness to the accountants Landis was so frustrated by, the Act gave only the outline of the regulation its authors intended. Subsequent to its passage, the accounting profession was hastily enlisted to help write the specific regulations: “When the Federal Trade Commission began to wrestle with the problem of interpreting the Act, as all of us know and as Commissioner Landis knows, the professional accountant was very happy to respond to the call of the Commission to assist in helping to frame some of the interpretive regulations. Our own president spent quite a few days...the American Society yanked three or four of us out from far more comfortable surroundings to work with them and the members of the Commission’s staff in the summer heat of Washington. The American Institute did likewise” (Landis Papers, Box 12, 1933). When he spoke before the New York State Society in October of 1933, Landis faced a barrage of technical questions from accountants on interpreting and complying with the Securities Act. His response to accountants’ concerns was essentially that they should trust him: “The standard is one of reasonableness. I repeat that over and over again: reasonableness.” SEC Chairman Joseph Kennedy also echoes these concerns: “Remember the Act is new – the Commission is learning” (Landis Papers, Box 12, 1933). What the profession feared were endless lawsuits against auditors anytime the share price of a company they had certified plummeted. Landis attempts to reassure accountants that the courts would limit the liability judgments against them in practice. Surely he knew that such ambiguousness would not reassure a hyper cautious accounting profession.

Given this, the almost universal hostility of historians to accountants' role in the creation of the Acts seems somewhat harsh. Their view is largely taken from Landis, who apparently possessed a great deal of hostility for George May particularly. Landis took the trouble of specifically singling out May for criticism in a brief (20 page) article in a legal journal, writing in a footnote: "Despite the fact now generally recognized that the registration requirements of the Securities Acts have introduced into the accounting profession ethical and professional standards comparable to those of other recognized professions, the then dean of the accounting profession, George O. May of Price, Waterhouse & Co., was strangely opposed to our proposed requirements for independent accountants" (Landis, 1959, p.35). Landis seems to have had in mind specifically the liability provisions of the Securities Acts. It was on this point that Wall Street would challenge the New Dealers, in what one historian has called "some of the most bruising lobbying struggles ever waged in Washington" (Seligman, 1982, p.72). George May played a leading role in this effort, which succeeded in scaling back the liability provisions under the 1934 Securities Exchange Act to state that the defendant may escape liability by proving that he had acted in good faith and had no knowledge that the financial statements were misleading.

For our purposes, the central story is how the profession lobbied for these amendments, how successful they were, and what parameters they set for accounting's lobbying in the future. The profession was able to bypass Congress and lobby Landis directly because, with Congressman Sam Rayburn's help, the bills were passed largely as the New Dealers wrote them. There is little evidence that May or anyone else met

with any congressmen specifically on the Securities bill, though there is abundant evidence they met frequently with Landis, Kennedy, and later Carman Blough as Chief Accountant of the SEC.

Why Landis chose to rely on accounting to set its own standards is made clear by his correspondence. He did not have the expertise to question accounting issues, and on more than one occasion is corrected by accountants on technical matters. The correspondence makes clear that the SEC was utterly dependent on accountants to prepare the Acts and subsequent accounting regulations. This is particularly notable in letters exchanged between Landis and leading accountants on the now standard phrase in the auditor's report, "in our opinion." Walter Staub, a senior partner at Lybrand, Ross, wrote to Landis expressing surprise that the use of the term "in our opinion" had suddenly been disallowed. In a careful response, and a subsequent one from May, both men lay out that the term is both appropriate, because as Landis himself had stated, accounting is more a matter of judgment than fact, and that it had long been in use in auditors' reports (Landis Papers, Box 7-5, 1933).

Landis' only option would have been to recruit an army of accountants to work for the SEC, rather than allow private accountants to set the regulations. There was certainly, among accountants in any case, a real fear that government would take the audit franchise for themselves. May would continue to write into the 1950s that such an outcome was "narrowly avoided" in 1933 (May Papers, 56-10, 1952). And Landis faced direct questions on this point: "This newspaper feared the setting up of a large bureaucracy to audit accounts of corporations and thereby to threaten the work of fifty

years or more in this country toward building up the standard of audits by independent certified public accountants” (Landis Papers, Folder 2-3, 1933). As many noted at the time, precedent did exist for American government intervention in public accounting. A capital issues committee had been created during WWI, and since 1920 the Interstate Commerce Commission exercised control over railroad securities (Weidenhammer, 1933, p.273). But the fears of accountants seem hyperbolic in retrospect. As historians of the New Deal, particularly McCraw and Parrish, make clear, the philosophy behind the Securities Acts, a product largely of Felix Frankfurter and his protégé Landis, was to set in place a broad structure of regulation under which private groups, including stock exchanges, lawyers, brokers, and accountants, would continue to operate. Large government bureaucracies would be unworkable and not in keeping with the philosophy of the New Deal (Parrish, 1970, p.208, McCraw, 1984, p.186).

A myth persists that the testimony before Congress of Colonel Arthur Carter, then President of the New York State Society of CPAs, is responsible for preventing a government takeover of the audit profession (see for example Zeff, 2003a, p.192). Carter’s testimony received scant coverage in the press (see *New York Times* 4/2/33 p.1 and *Wall Street Journal* 4/3/33 p.8), and little reference was made to it at the time by any of the players in the creation of the Securities Acts.

What emerges most clearly from the extant historical record is the unwarranted harshness of opinion from both sides. The Securities Acts left the accounting profession in charge of regulating itself, even though it had shown scant ability to do so in the past. Setting the exact parameters for the relationship between the accounting profession and

its putative overseer, the SEC, would be a difficult process that took place over several years, frequently evolving by way of crises and ad-hoc decision making. Little wonder it proved so difficult.

One question in particular has exercised historians' skills: what impact finally did the Securities Acts have on American business generally and financial reporting specifically, and how effective has the SEC been?

The most comprehensive economic analysis of this question is "Required Disclosure and the Stock Market: An Evaluation of the Securities Exchange Act of 1934" by George Benston (1973). As he writes, "The economic rationale for the regulation of the securities markets was not examined carefully before the legislation was passed (which is not surprising given turbulent times) nor has it been since" (Benston, 1973, p.132). All companies listed on the NYSE and the Curb (American) Exchange were already required to undergo annual audits by independent CPAs when the Securities Acts were enacted, and these combined included 83% of all publicly traded companies (Benston, 1973, p.142). Further, Benston's econometric analyses find no support for the contention that the Acts improved the quality of published financial statements.

My own unscientific review of several companies' financial statements from the 1920s and 1930s largely confirms Benston's view, and suggests that the Securities Acts had little impact, at least on the form of financial statements and auditor's reports. Among the thirteen companies studied, twelve annually underwent audits for several years prior to the Securities Acts, although generally only the balance sheet was audited

even when an income statement was also presented. The length and detail of the financial statements shows little evolution throughout the period studied, including in the years after the Securities Acts. Extensive Management Discussion and Analysis sections also predated the Securities Acts. These usually review the company's performance for the past year and often discuss accounting issues. For example, S.S. White Dental Manufacturing Company includes in its 1931 MD&A: "Among the items of major importance should be mentioned the write-off necessitated through the depreciation of foreign exchange, particularly the loss sustained through the abandonment of the gold standard by Great Britain in the early fall" (Hagley Museum and Library, Annual Reports, 1931). The 1933 Act mandated the presentation of three years' comparative statements, but this appears to have been a practice not uncommon in the 1920's. Goodwill, patents, and trademarks are frequently included as assets and amortized annually. For most companies, inventory and accounts receivable were not directly confirmed before the reforms following the McKesson Robbins scandal (See Ch.3) .

This leaves the question: were auditors truly independent of management before the Securities Acts? The conclusions of May, Carman Blough, and Warren Nissley, all leaders of the profession in this era, as well as that of James Landis, suggests the answer is no. The extant historical record leaves little basis to challenge this conclusion, since little correspondence between management and their outside auditors survives from this era. But among the evidence available, two supplementary audit reports offer an intriguing challenge to the conventional view of the public accountant's place vis-à-vis his client in the pre-New Deal era. Reports prepared to accompany the annual audits by

Lybrand, Ross Brothers and Montgomery for Lukens Steel Company for the years 1925-34 (Hagley Museum and Library, Accession No.50, Box 2187) and by Ernst & Ernst for Strawbridge and Clothier for 1923 (Hagley Museum and Library, Accession No. 2117, Box 18) suggest that an auditor's role in these years far exceeded mere footing of accounts. The substance of these reports seems closer to the modern role of the auditor, suggesting improvements in the client's accounting and internal control practices. From Lybrand, Ross Brothers 1927 report to Luken Steel: "Your company's policy with respect to charges for repairs, at least during the period of our examination, has been most liberal, and we noted in the fiscal years ended October 31, 1924 and 1925, a number of items classed as repairs, amounting in the aggregate to a substantial sum, which in our opinion, under a stricter accounting might have been handled either as capital charges or as charges against the reserves for depreciation." And from 1929: "It therefore appears that the payment of such a bonus represents a distribution of a part of the Company's profits to its officers and men rather than an operating expense and as such is properly shown as a non-operating charge" (Hagley Museum and Library, Accession No.50, Box 2187). We can also see Ernst & Ernst standing its ground with Strawbridge and Clothier in 1923: "We made test checks of the quantities on hand in the store...A notable difference that existed was in the China Department, which we made the subject of a special investigation and ascertained the reasons for the existence of the difference. This was mainly occasioned by the fact that the Retail Inventory Method had not been carefully followed in that department, and as a result of several conferences

with the department head and your Comptroller we believe better results will be obtained in the future” (Hagley Museum and Library, Accession No. 2117, Box 18).

But this belies the conclusions of virtually all the participants. Carman Blough describes the changes wrought by the Acts this way: “One can hardly imagine the impact on the financial and accounting world of having previously confidential information on over 2,000 companies suddenly thrown open to the public” (Blough in Cooper and Ijiri, eds., 1979, p.36). As noted previously, the Acts brought uniformity and comparability to financial statements and to the attached auditor’s report, which in the 1920’s frequently included so many qualifications to the auditor’s opinion as to make them virtually worthless (Taylor in Previts, 1981, p.76). Whether this would have been achieved by private initiatives such as *Audits of Corporate Accounts* will remain a mystery, since the Securities Acts followed so closely on the heels of this publication.

CHAPTER IV

THE EVOLUTION OF THE PROFESSION, 1935-1956

The reforms of the New Deal, wrenching as they were for accounting, had little impact on the profession over the course of the 1930's. The Wall Street elite, men like George O. May, remained firmly entrenched in the profession's leadership, much to the consternation of accounting's new overseers at the SEC (Parrish, 1970, p.208), and the contention that the Securities Acts improved the quality of financial reporting is open to dispute (See Chapter III). The forces driving public accountancy towards higher standards of professionalism would work slowly over the next two decades. The unification of the profession into one national organization in 1936 was the first step towards broadening the leadership's outlook to embrace CPAs throughout the United States. The McKesson-Robbins scandal would undermine the elite's claim to leadership of the profession and open a path for a new generation with a more expansive view of the profession's responsibilities (Carey, 1970, p.40). The massive increase in the profession's numbers caused by the move away from temporary audit workers in the wake of McKesson-Robbins, the domestic labor shortages of World War II, the demand for tax accountants as government increasingly relied on income taxes to fund the cold war, and the postwar economic boom all led to a reorientation of the profession's national leadership towards the needs of the small, local practitioner and away from the Big-8 firms.

Previts and Merino look disapprovingly on this period in the profession's history: "The stress on limitations seems to have had unfortunate ramifications. In

subsequent years, the emphasis continued to be not on what auditors can do, but on what they cannot do. This negative orientation raised serious questions about the willingness of the profession to meet its social expectations effectively...[Accountants] have been reluctant to extend their activities to become societal watchdogs...After WWII, when accountants could have pressed to extend their responsibilities, they did not” (Previts and Merino, 1998, pp.293, 318). I believe their conclusions are based on a too narrow focus on controversies surrounding corporate financial reporting. By the late 1950’s, an evolution in accounting’s leadership had taken place, manifested most clearly as the AICPA eagerly offered its services to help clean up corruption in pensions and trade unions during the labor corruption scandals of the 1950s, accepting a new role (and new legal liability) as financial watchdog that brought it closer to an altruistic model of a profession with responsibilities to society. But CPAs would also become more aggressive in protecting their professional turf, and in expanding the profession’s reach to any new line of business that offered additional revenue, including management consulting. And accounting would lose the image that the old Wall Street elite had for CPAs, of a profession above politics and self-promotion, a disinterested profession.

I. The Merger of CPAs

John Carey, in his official history of the AICPA, describes the division of the profession into two rival national associations as the “Great Schism”. Since 1921, and crucially during the New Deal reforms, accounting lacked an authoritative voice as CPA’s divided along lines of clientele as well as class. When the AIA and ASCPA finally merged in 1937, the profession took a crucial step forward in its evolution.

The leadership of American accounting in its formative years was comprised largely of transplanted British accountants, most notably George O. May. These men headed the largest American firms that were headquartered on Wall Street and whose clients included the largest American industrial enterprises. As the American economy expanded in the first decades of the twentieth century, the demand for CPAs expanded beyond the confines of New York, and the typical American accountant increasingly became a sole practitioner doing basic accounting, tax, and auditing work for small and mid-sized businesses. These accountants were also often first or second generation Americans from Central and Eastern Europe, creating further tensions with the Wall Street elite. As John Carey wrote, many accountants were “suspicious of a national organization whose headquarters was in New York, and many of whose prominent members were of British origins” (Carey, 1970. p.324).

Tensions reached a boiling point when the American Institute of Accountants reorganized in 1916 and relegated all accounting educators, financial controllers, and cost accountants to non-voting status within the organization. As a result, all three of these groups formed their own associations (Miranti, 1990, p. 134). In 1921, the AIA voted to follow the example of the American Bar Association and ban advertising by members. It was this issue more than any other that would truly divide the profession. The Wall Street firms obtained sufficient business without the benefit of advertising, but smaller practices around the country did not have that luxury. The final straw was the AIA’s attempt to supersede the treasured CPA designation with their own certification available only to AIA members. In the uproar over this attempt to relegate the vast

majority of CPA's to second-class status, the American Society of Certified Public Accountants was created in 1921 (Miranti, 1990, pp.119-120, Carey, 1969, p.324).

Over the course of the 1920s, the AIA continued to isolate itself from the majority of the profession. The national firms concerned themselves primarily with the sophisticated accounting required for big, publicly traded companies, issues of little relevance to practitioners serving small businesses. For some in the AIA, admitting a broader swath of the profession into their organization risked cheapening their status. George May concluded in 1928: "The *raison d'être* of these rival societies is largely an unwillingness to accept the Institute's standards of ethics" (May papers, 53-6, 1928).

By the 1930s, the Schism was making both national organizations increasingly irrelevant. The majority of CPAs belonged to neither group. Instead, the state societies were the primary organization most accountants turned to. As one AIA member lectured his peers: "I think that the Institute is at the crossroads, and the council has got to decide whether or not it intends to remain a smug, concise, small organization, representing high ideals and a certain group of the accounting profession, or whether it wants to go on and be truly representative of the entire profession" (Carey, 1969, p.362). This hostility towards the AIA put increasing pressure on the accounting elite to broaden their membership: John Carey writes that most CPA's favored a merger between the AIA and the ASCPA, and that "the Institute was generally unpopular" with the rank and file of the profession (Carey, 1969, p.357-8). Some began taking steps to modernize the profession without the national organizations. In the early 1930's, Arthur Young partner

Warren Nissley spearheaded a push to recruit more college graduates into the profession rather than relying on importing British chartered accountants (Higgins, 1965, p.123).

Paul Miranti concluded that the profession's divisions were largely responsible for the profession's slow response to the tumultuous events of the late 1920s and early 1930s. As we have seen, it was the accounting elite, led by May, that embodied the public face of accounting during these years, but their authority was undermined by the fact that they spoke for a small minority of practicing CPAs (Carey, 1969, p.355). As Miranti writes, it was a desire to present a stronger, united front that motivated the AIA to finally merge with the ASCPA in 1937. This was a crucial step towards the democratization of the profession, providing all practicing CPA's with equal status within the national organization and thereby forcing it to address the needs of CPA's beyond Wall Street.

II. Standard Setting

Although the two rival organizations had made peace, the Wall Street elite retained effective control of the AIA. When the SEC began to press accountants to develop more standardized rules for financial reporting, men like George May resisted, believing the brief *Audits of Corporate Accounts* was sufficient and that the details of financial accounting should be left to professional judgment. It would take prodding from the SEC to motivate the profession. This effort was led by SEC Chief Accountant Carman Blough, who told the New York Society of CPAs in 1937: "Almost daily, principles that for years I had thought were definitely accepted among the members of the profession are violated in a registration statement prepared by some accountant in

whom I have high confidence. Indeed, an examination of hundreds of statements filed with our Commission almost leads one to the conclusion that aside from the simple rules of double entry bookkeeping, there are very few principles of accounting upon which the accountants of this country are in agreement” (Zeff, 1971, p.132). John Carey would write: “The cumulative effect of this speech was devastating” (Carey, 1970, p.11). Blough would later add: “Unless the profession took steps to reduce the areas of difference in accounting practices the Commission would” (Zeff, 1971, p.132). The SEC in fact had little desire to write accounting rules themselves, both because most of them were not accountants and because they had little staff to do the work (Seligman, 1982, p.197-201, Chatov, 1975, p. 178; see also Cooper & Robinson, 1987, p.137-140). It was Blough’s hope that the profession would accept the challenge: “I have emphasized at numerous times that the policy of the Securities and Exchange Commission was to encourage the accountants to develop uniformity of procedure themselves, in which case we would follow” (American Institute of Accountants, 1937, p.190).

Although the profession certainly merits criticism for its reluctance to write standards, Robert Chatov also sees their response as consistent with the common law tradition of the United States and Britain. Whereas “systematic legal codification is the method of the civil code nations,” including most of Europe, in the United States and Britain ad-hoc court decisions form the basis for the legal environment. From this followed the position of the profession’s leadership that accountants should follow accepted practice rather than write an extensive body of rules (Chatov, 1975, p.178-9).

Capture theory, the idea that the regulating agency eventually falls under the influence of the group it is regulating, may also explain the SEC's reluctance to take the rule-making power away from accounting practitioners. Chatov writes of the SEC's battles of the 1930s: "The entire process illustrates the limited power of an independent regulatory agency in the face of massive resistance from its regulated constituency" (Chatov, 1975, p.182).

Certainly the SEC was not happy with the progress accountants made in taking control of financial reporting practices. The Committee on Accounting Procedure, a creation of the AIA, finally began issuing regular pronouncements in 1939, but this did not relieve concerns at the SEC that accountants remained beholden to their clients. Upon being named SEC Chairman in May of 1939, Jerome Frank pronounced: "We want to be sure that the public never has reason to lose faith in the reports of public accountants. To this end the independence of the public accountant must be preserved and strengthened" (NYT 5/19/39 p. 36. See also Carey, 1970, p.61).

We can begin to see in the fight over accounting standards the demarcation that would symbolize the profession's evolution in the coming decades. This fundamental philosophical difference was personified in George O. May and Carman Blough. May, as we have seen, represented the older generation dominated by the Wall Street elite. He grudgingly tolerated the SEC and anyone else who tried to tell accountants how to practice accounting. He fought the standard setting process, believing well-trained professionals should rely on their own judgment, and was reluctant to expand the AIA's membership to accountants he saw as inferior in quality. He also disdained public

relations of any kind, not only because it was unnecessary for the national firms to retain their oligopoly with big business clients but because he saw it as demeaning to a professional's status. He was not alone in his views. In his valedictory address in 1937, retiring AIA president Robert Montgomery gave a stern warning about a vision of the profession that saw more responsibilities for CPA's: "When I look down upon you from my mansion in heaven fifty years from now, I shall be content if I find our profession then has the same prestige as it has today...If you have gained the whole world and lost your souls, I shall mourn bitterly even though my place in heaven is permanent. We have been told so often that we cannot remain still, we must go forward or backward, that we are inclined to believe it. Nevertheless, I ask the profession to stand still. I do not want it to change" (The American Institute of Accountants, 1937, p.89-90).

On the other side was Blough, who in background and philosophy was closer to the ASCPA (Miranti, 1990, p.153). He had grown up in Wisconsin and worked his way up through state government before coming to work for the SEC. It was the ASCPA that had made its headquarters in Washington (the AIA was headquartered in New York), developing relationships with Congress and the regulatory agencies (Carey, 1969, p.354). As we will see, when Blough became Director of Research for the united AIA, he would emphasize the needs of small practitioners over those of the national firms. In contrast to the insular Wall Street elite, Blough, as first chief accountant of the SEC, understood the need to propitiate the SEC, Congress, and the investing public in order to retain control over the standards CPA's worked by. This would involve not only sedulous attention to developing accounting theory and standards on issues relating to

big business, but also in developing the professionalism of CPA's working in small, local practices. Blough would play an important role as part of the new generation that would lead accounting in the postwar era. The antiquated nineteenth century British gentleman model that disdained formal regulations, looked suspiciously on professionals from different backgrounds, and rejected the adversarial relationship between auditor and client that the New Dealers envisioned would be pushed aside, not directly by the Securities Acts, but by the demands the American marketplace thrust upon it.

III. The McKesson-Robbins Scandal

Before Enron and WorldCom, the most notorious accounting scandal in American history was McKesson-Robbins. The revelation that systematic fraud had been perpetrated under the nose of the profession's premier firm, Price Waterhouse (the firm of George O. May), made headlines in newspapers all over the country and led to major changes in audit procedures. It also proved a major blow to the elite generation's control of the profession, both to its prestige and to its numbers, as the practice of relying on temporary workers came under greater scrutiny and the ranks of full-time CPAs swelled.

The man at the center of the McKesson-Robbins scandal was Philip Musica. By the time he crossed paths with the auditors at Price Waterhouse, he had twice pled guilty to fraud, once in 1909 and again in 1913. By 1923, he had set up a small chemical manufacturing concern called Girard and Co., with himself as President, under the name Dr. Donald Coster. As his biographer writes: "Just how much of the thriving little company's business was legitimate was hard to determine even by contemporary

records” (Keats, 1964, p.69). In any case, the business continued to expand, and by 1925 Coster decided he needed the legitimacy of an audit by the premier American firm, Price Waterhouse. PW did no background check on Girard or Coster before agreeing to take the engagement (SEC, 1940, p.146). From this point until the scandal was revealed in 1939, PW would annually issue clean audit opinions on Coster’s businesses.

Coster had the idea to form a national drug wholesale distributorship, and for this purpose convinced investors that Girard and Co. should buy up various drug wholesale concerns. In October, 1927, he issued a prospectus proposing a merger of Girard & Co. with McKesson-Robbins (SEC, 1940, p.28). By 1927, more than \$1 million in stock had been sold in the new company.

Before the Securities Acts, there was no requirement that publicly traded companies undergo audits, although it was common to do so, and the exact scope of the audit was largely a private arrangement between management and the auditor. The SEC report on the McKesson-Robbins scandal includes the initial engagement letter Coster sent to PW, in which he emphasizes that the auditors should confine themselves to checking the employees, not the management, of McKesson-Robbins. This is perhaps the clearest evidence available of the position auditors found themselves in before regulations required audits: they were at the mercy of management, and had little real independence in how they conducted their work. A client could simply dismiss an audit firm that challenged its accounting and hire a more pliant one, as this comment from a Price Waterhouse partner suggests: “McKesson and Robbins, Inc. has become a large organization, and we consider the connection of sufficient importance to warrant our

making every effort to clear up without delay any sore spots which may develop among the executives” (SEC, 1940, p. 172).

Coster had learned from his Girard experience how to mislead his auditors. As a book he kept on his desk explained: “It is the nationwide custom of banks and corporations to submit annual reports and financial statements, examined and approved by certified public accountants. Upon these sworn certificates, stockholders rely and investors base their judgment...The truth which the public has never been told is that no practical system has ever been devised by which the complicated finances of a large institution can be thoroughly checked up so that every transaction is verified, except at prohibitive time and cost” (Keats, 1964, p.120). At Girard, Coster had simply created fraudulent documents that the auditors accepted as inventory records. Over the next several years, as Price Waterhouse regularly issued clean audit opinions of McKesson-Robbins, Coster and his three brothers, who all held executive positions in the firm, continued to manufacture documents relating to inventory and accounts receivable records. Price Waterhouse, following standard but not best practices within the industry, confined its audit to a check of the records, not the actual inventory. Nor did PW directly contact any of McKesson Robbins debtors regarding the accounts receivable (AICPA Archives, statement by AIA 3/4/39).

Reading the SEC’s exhaustive report today, the reader is struck by the parallels to the Enron scandal. Like Enron, there were abundant warning signs of trouble. George O. May would lament: “The distress that I naturally feel about the whole affair [is]to think that we had a glorious opportunity to discover a great fraud and failed to

make the most of it” (May Papers, 69-3, 1939). In a footnote of the SEC Report, PW makes clear it was aware of potential problems in a letter to McKesson Robbins: “In submitting the December 31, 1932 financial statements which we have sent you to date, we have called your attention, in the case of a number of companies, to the fact that there is not an adequate system of internal check to protect them against irregularities and misappropriation of funds” (SEC, 1940, p.154).

The fraud itself was finally exposed in December, 1938, when Julian Thompson, Coster’s top assistant, confronted Coster with his suspicions that the Canadian warehouse of McKesson Robbins did not, in fact, exist. In a complex effort to shield the company from investigation, Coster had the firm put into receivership, which raised alarm bells through Wall Street and led to the SEC investigation and exposure of the fraud. Coster, a.k.a. Philip Musica, committed suicide (Keats, 1964, p. 172-5).

On the night of Sunday, December 4, 1938, when word of the fraud spread through Wall Street, a hurried meeting was called by Sidney Weinburg, a Governor of the NYSE who also sat on the Board of Directors of McKesson Robbins. Among the people he roused out of bed that night was George O. May, as the senior partner of Price Waterhouse in New York City.

The case was sensationally covered in the New York Times and elsewhere. May’s humiliation as the scandal was made clear can only be guessed at. A man whose personal integrity was beyond reproach, long retired from active work in audits and now an elder statesman of the profession, had to explain how his own firm had been unwittingly complicit in a fraud that had been going on for fourteen years. This is all

made painfully clear in a correspondence between May and J.M.B. Hoxsey in the wake of the McKesson-Robbins scandal. It will be recalled that Hoxsey was May's chief contact at the NYSE when *Audits of Corporate Accounts* was prepared. The two had been applauded in the press as partners in this effort (May Papers, 61-9, 1931). Now, an obviously anguished Hoxsey writes May: "I feel now that I advised the Stock Exchange badly in 1932 and 1933...it simply did not occur to me to doubt that inventories and receivables were spot checked" (May papers, 69-3, 1939). As late as the 1950s, May would refuse to write an article on McKesson Robbins for the *Journal of Accountancy* and his extensive correspondence includes only a few curt references to the scandal.

Hoxsey's regret would seem to validate the concerns that many inside and outside the profession had expressed since *Main Street and Wall Street*. As I discussed, most historians have followed the view of James Landis that the audit profession at the time of the New Deal had not obtained the level of professionalism needed in order to carry out the responsibilities granted to it under the Securities Acts. The McKesson case raised concerns that this remained true in 1939. Following generally accepted procedures, Price Waterhouse had been duped over a period of 14 years. It did not confirm receivables or inventory by physical inspection, and relied on temporary workers and poorly trained accountants who did not understand the business they were auditing.

The scandal offers a window into how the profession's public relations skills had developed since the New Deal years. Unprecedented pressure was placed on the profession to revamp its audit procedures; within a month of the public revelation of the

scandal the Attorney General of New York summoned leaders of the AIA to his office to discuss what reforms were needed, and his office issued a statement that “The Coster-Musica case [has] revealed certain fundamental weaknesses in the preparation of financial statements of large corporations” (NYT 12/24/38 p.4). The new chairman of the SEC, Jerome Frank, hoped the fallout from McKesson-Robbins would mark “a turning point in accounting standards” and called on accountants to take the lessons of the scandal to heart and begin to accept the responsibilities the New Dealers had laid out for them seven years before: “Without in any way indicating what the applicable law and morals may have been in the past, I suggest that the McKesson-Robbins case...raises, for the future, certain questions with respect to corporations whose securities are listed or registered. While the controller serves not only the management but also the stockholders, should not the accountant serve the management and the stockholders and the bondholders and other creditors? And should not the accountant serve not merely the existing stockholders and bondholders, but all future investors?” (NYT 1/9/39 p.45).

All this unwanted public scrutiny startled the profession and led to a quick response: by May of 1939, six months after the scandal broke, new procedures were put in place requiring physical checking of inventory and confirmation of receivables. Many counted the profession lucky to have avoided a government takeover of the setting of accounting standards (May Papers, 56-10, 1959; “McKesson-Robbins”, 1941, p.1). A new tone could be detected in response to the SEC’s investigation in the scandal: “Such an investigation might not be proper in the case of any other profession, but certified

public accountants recognize a dual responsibility which is unique – a responsibility to the client and a responsibility to the public which may rely upon the accountant's report. It was no doubt in the belief that the investing public, as represented by the S.E.C., had a right to know all it wanted to know about generally accepted auditing procedure that the accounting profession cooperated fully in providing the desired information” (“McKesson-Robbins”, 1941, p.1).

But not everyone had gotten the message that a new, humbler tone was the order of the day. The haughtiness that so annoyed James Landis was still in evidence in comments like this from T.C. Andrews of the AIA: “It is offensive to members of the profession to suggest that the work of developing its technical and professional standards should be taken from the hands of the profession itself and be assumed by a department of the federal government” (NYT, 4/23/40, p.35).

Besides making at least many in the profession more aware of the power of public opinion, McKesson-Robbins offered an opening to the smaller firms that desired a greater say in the profession. At a meeting with members of New York Governor Lehman's staff, the *New York Times* reported: “A number of [speakers] charged that about 90 per cent of all the brokerage and investment firms, as well as the greatest industrial firms listed on the Stock and Curb Exchanges, were audited by six or seven great firms of which Price, Waterhouse, and Co., auditors of the McKesson-Robbins company, was one. With this was coupled a charge that the officials of these firms dominated the New York State Society of Certified Public Accountants and the American Institute of Accountants which resulted in a too lenient interpretation by the

Association of principles which should be applied to all accountancy activity. Speakers declared that where small accounting firms, auditing smaller business houses, made it an almost invariable practice to check on statements of inventories and of accounts receivable before listing them in audit, the larger accounting firms, dealing with the books and records of the larger houses, in general accepted the statements of officers of the companies audited and put them into balance sheets without further checks” (NYT 1/7/39, p.11).

Remarkably, the profession was allowed to implement its own reforms after McKesson-Robbins. The new audit rules regarding physical inspection of inventory and confirmation of receivables satisfied the SEC, and the profession retained control of setting accounting standards. This must be seen as the final coronation by the federal government of the accounting profession’s power to police itself: even in the wake of this scandal, the SEC refused to reconsider its decision in the early 1930s to leave accounting to the accountants.

The use of temporary workers had also come under sharp criticism in the SEC’s report, spurring a revamping of staffing by the major firms that would have far-reaching consequences. Accounting’s elite had held on to the reins of power through control of the large, national firms. Relying on temporary workers for the largest audits left a relatively small number of partners at the top of these firms. After McKesson Robbins, the practice of using these largely untrained workers fell into disrepute, and the large firms were forced to employ more full time accountants, all of whom would become CPAs and be eligible for partnership and a voice in management.

The profession had survived intact, but the weaknesses in the old guard leadership had been exposed, and the scandal brought new opportunities to the forces that would challenge this leadership.

IV. The Profession in World War II

The mobilization of the American economy for war placed unprecedented demands on the accounting profession. Both the draft and the increased needs of government agencies shrank the number of accountants available for the continuing needs of American business. New responsibilities and new entrants into the profession - particularly, for the first time, women - expanded the profession's reach while simultaneously reshaping its membership, preparing accounting for the postwar expansion that would democratize the profession and prepare it to take its proper place in American society.

A shortage of trained accountants confronted the profession quickly after Pearl Harbor. By December 1942, public accounting firms had lost from one-third to one-half of their pre-war staffs (NYT, 12/18/42, p.43). Along with the draft, this shortage came from the massive enlisting of accountants for work in government agencies. A unified and, in the wake of McKesson-Robbins, perhaps chastened profession responded with a new alacrity, as the *New York Times* told its readers: "Recognizing that accounting has become an indispensable element in war production and in control of the government's vast expenditures, the executive committee of the American Institute of

Accountants yesterday announced adoption of a war activities program to remain in effect for the duration” (NYT, 11/10/42, p.41). As quickly as January 1942 practitioner journals were advising their readers of the new issues their clients would be facing, from contingencies in the face of uncertain payment from government funds to questions as to whether “accounting reports may be of value to enemy forces,” and whether subsidiaries of clients now in enemy hands could still be listed as assets on their balance sheets. (Towns, 1942a, p.270).

Wartime demands put strains on all aspects of the American economy not engaged in war production, and the work of auditors was no different. Partly in response to requests from accounting firms, the New York Stock Exchange extended the filing period for annual reports, and in an ironic decision, the stricter requirements for the physical inspection of inventories, put in place after the McKesson-Robbins scandal, were suspended. (NYT 12/18/42 p.43, Towns, 1942a, p.372).

Government agencies frequently turned to the large accounting firms when the scale of war contracts became overwhelming. Accountants found themselves responsible for audits by the War and Navy Departments, allocation of critical materials by the War Productions Board, and financial reporting under price fixing programs. An estimated 10,000 accountants were hired by the Army alone to audit war contracts (Towns, 1942a, p.372). Financial reporting issues specific to the war effort were the subject of a great deal of professional literature. Contingent liabilities involving the uncertain collection of government payment for war contracts had been handled with footnote disclosures through 1942, when “some companies met with rude surprises in

the effect which actual settlements had on that year's operating results.” (Donald P. Perry, 1944, p.137). As factories around the country began running overtime to meet the demand for war materials, accountants had to make new accelerated depreciation estimates, an issue that was made particularly vexing since no one knew how long the war would last (Towns, 1942a, p.373).

Perhaps the most prominent impact of the war on the work of accountants was the substantial increase in personal income taxes and new excess profits taxes. Taxes before the war had affected a maximum of 6% of the population (Zelizer, 1998, p.84). The increased complexity and scope of the tax code gave birth to a swelling of the ranks of tax accountants that would continue in the postwar era as tax rates remained high. (Towns, 1942a, p.374, Perry, 1944, p.139).

Like all other professions, accountants had to negotiate with Selective Service officials to keep as many trained accountants as possible working on corporate engagements. CPAs were early on designated an essential occupation, however “no employer should hope for occupational deferment of any able-bodied accountant under 26 years of age, regardless of dependents or professional skill” (“The Manpower Problem”, 1944, p.65). Professional exemptions were often unevenly enforced by local draft boards, and it was necessary to show that the client's work, and the outside auditor's contribution to it, were essential to the war effort (Higgins, 1965, p.192). In practice, accounting firms were frequently frustrated in their efforts to retain key employees (Carey, 1970, p.47).

For all the challenges the profession had to confront in these years, the war proved a tremendous boon for the profession. Among other things, the unprecedented scale of war contracts led to innovations in business management and recordkeeping. “There is no doubt but that WPB and OPA have forced many businesses to develop more adequate records” (“War Has Changed Old Bookkeeping”, 1944, p.273). To implement machine recordkeeping such as punch-card systems, the large accounting firms were often brought in as consultants (Higgins, 1965, p.188). As one writer summarized it, “Prior to the war, the average accounting practice was largely composed of audit work and preparation of tax returns, sweetened on occasion by nonrecurring system engagements or cases dealing with new financing. The scope of services rendered by accountants has been considerably extended in wartime, and it seems probable that the success of the profession in handling these varied assignments may result in a wider field of practice in the future. The problems of business management have been tremendously complicated by the network of wartime controls in the face of expanding volume, and shortage of managerial manpower has led many clients to turn to professional accountants for assistance” (Perry, 1944, p.139).

Perhaps the most profound change the war brought to accounting was the massive influx of new people brought into the profession due to manpower shortages. As with the ending of the practice of relying on temporary workers in the wake of the McKesson-Robbins scandal, the demands of the war further diluted the elite’s control over the profession. Most prominently, women entered the ranks of accounting in large numbers for the first time. Prior to the war, accounting was considered “the most

difficult of all the professions for women to break into,” and women encountered engrained prejudice from accounting professors who discouraged them from even studying accounting, to clients reluctant to take the advice of female auditors, to the accounting firm partner who proclaimed he would “go out of business before he would employ a woman on his staff.” But by 1943, 8.4% of the accounting workforce was female and the long-term expansion of the profession would require a continuation of this trend. A shortage of trained accountants had existed even before the war, and the expansion of client services, in part a result of wartime needs, meant that accounting had to change with the times. The war brought a virtual sea-change in attitude towards the employment of women, with one university official writing: “The field is definitely a growing one for women, at least while the war lasts. By peacetime women will have proved themselves capable and will never again be discarded in accounting firms.” As one Jennie Palen proudly concluded in the *Journal of Accountancy* in July, 1945: “It is the testimony of those who are now employing women accountants [that gives reason to be hopeful of women’s prospects in accounting]. These men, partners in the larger accounting firms, all leaders in accounting though and men in the forefront of accountancy’s activities, have given, with heart-warming frankness and sincerity, an overwhelming endorsement of the woman accountant and a promise for her future. A cross section of these opinions, solicited in March, 1945, presents unimpeachable testimony that women on public accountants’ staffs have been highly satisfactory, that clients have not objected to them, that the seniors whom they were assigned to liked

them, that they are to be kept on after the war, and that they will be advanced in rating as they merit such advancement” (Palen, 1945, p.27).

V. Postwar Expansion and the New AICPA

CPAs often spoke during the war of the patriotic service they had contributed by working on government contracts to keep the Arsenal of Democracy running at full speed. With the end of the war, the profession found itself with newfound respect (Carey, 1970, p.53). The expansion of the profession’s ranks would continue in the postwar era, a consequence both of the economic boom and of accountants broadening their reach to become accepted as experts in expanding fields like taxation and management advisory services. Perhaps most significantly, the leadership of the profession would pass from the old guard of the 1920s and New Deal era to a new generation. Men like Carman Blough and John Carey would aggressively pursue a strategy that raised accounting’s profile and extended its reach, determined to make accounting a premier American profession, worthy of a place alongside law and medicine. By the early 1960s they had largely succeeded.

The size and complexity of the American economy and government reached unprecedented scales in the postwar era. Big business had reaped most of the gains from government contracts during the war, and now had huge retained profits with which to expand (Sobel, 1975, p.139). The war had also spurred innovations in the use of automated equipment in business. All of this required more accountants to audit, track costs, and advise their corporate clients. High tax rates to pay for the war effort and to keep inflation under control were largely kept in place after the war, and the era

of ever-expanding tax deductions to encourage desirable behavior like stock investing and R&D created a huge demand for tax accountants (Bruchey, 1990, p.490).

Government spending also grew in this era, largely in defense expenditures, creating another niche for accountants as government adopted the latest methods of cost tracking (Patterson, 1996, p.64).

Americans continued to prefer private regulation and market forces to the heavy hand of government oversight of the economy. With the exception of a handful of anti-trust suits, big business continued to flourish and even increase its dominance of the corporate landscape. The Wagner Act of 1933 had codified labor's right to collective bargaining, and powerful unions now jostled with management over wages and benefits. Despite the generally popular expansion of government under the New Deal, the uniquely American "private welfare state" of employer-sponsored pensions and health care continued to expand in the postwar era (Zelizer, 1998, p.5).

The stock market spent twenty years in the doldrums after the 1929 crash. Even as business reaped huge profits from wartime contracts, stocks continued to lag: "The Great Depression produced a generation of Americans who no longer believed in purchasing stocks" (Sobel, 1975, p.74). But the unprecedented prosperity of the postwar era finally produced a bull market beginning in 1952. For the rest of the decade, as long as business expanded and stocks continued to climb, there was little pressure for additional regulation. These years are often described as a low point for the SEC, which saw its staff and prestige sharply reduced from the heyday of the 1930s (Sobel, 1975, p.156).

Given this atmosphere, it is commendable that the accounting profession continued along the path of developing its professionalism. Carman Blough was among the leaders in this effort. He became Director of Research for the AIA in 1948. Blough would continue to prod accountants to adopt more uniform procedures for audits and financial statement preparation, as he had done in the 1930s as Chief Accountant of the SEC (Carey, 1970, p.156). He did this with speeches and a regular column in the *Journal of Accountancy*, “Carman Blough’s Accounting and Auditing,” where he clarified technical accounting issues and encouraged the use of best practices.

John Carey, now Executive Director of the AIA, became the profession’s cheerleader. Through importuning, self-conscious editorials in the *Journal of Accountancy*, he encouraged a sense of pride that challenged members to embrace the “Social Responsibilities of CPAs” and constantly congratulated them on their progress: “Such rapid growth might have resulted in disorganization...on the contrary, professional organization has improved...A vast amount of work remains to be done before the CPA will be universally accepted as the equal of his colleagues in the older professions, [but] for the first time, it seems to us, it may be said that the rough framework at least has been completed...to complete the structure of the accounting profession” (“Social Responsibilities of CPAs”, 1954, p.33). Appearing before Congressional committees as expert witnesses was one avenue towards raising the profession’s status. CPAs had begun working with Congress more frequently during World War II doing auditing and cost-tracking work on government war contracts. In the postwar years, the federal government increasingly looked to accountants to bring

modern accounting techniques to bureaucracies like the ICC, advocating the use of depreciation accounting and statistical sampling techniques among many other innovations. Accountants would now regularly begin their testimony by identifying themselves as representing the AIA, “the largest national organization of CPAs”, and presenting the Institute as including a broad swath of practicing CPAs in the U.S. This stands in contrast to Col. Carter’s 1933 testimony on the Securities Acts, where he claimed only to be speaking as President of the NYSSCPA.

The increasing complexity and ubiquity of taxes were a boon to the accounting profession. High progressive tax rates combined with numerous tax deductions to encourage socially desirable behavior (e.g. home-ownership, donations to charity) “transform[ed] taxation into a central component of economic and social policy” (Zelizer, 1998, p.27). From 1939 to 1944, the number of Americans paying federal income taxes increased from 4 million to 44 million (Zelizer, 1998, p.85). These tax rates were kept in place by Presidents Truman and Eisenhower to fund the military during the Cold War. The ability of the American profession to carve out tax practice for CPAs (as opposed to lawyers, who largely disdained this work in the 1920s) probably did more to identify accountants as professionals in the public mind than even the Securities Acts. An entire profession of tax accountants, whose work had little substantive connection to that of the auditor, fell under the umbrella of the American accounting profession. The AIA now regularly advised Congress on tax policy. The work of tax accountants, economists, and lawyers as advisors to government “also helped to promote into Congress a new type of political elite to represent the public

interest. Until the 1940s, two organizations had secured the right to claim that they represented the citizen within the tax policymaking process: interest groups and political parties. Economic experts still had limited access to the congressional leadership despite their gains within the executive branch” (Zelizer, 1998, p. 82) The improved standing of the accounting profession was noted by Congressman Wilbur Mills, chairman of the House Subcommittee on Internal Revenue Taxation: “The American Institute of Accountants has rendered a valuable public service in the attitude that the organization has taken with respect to improvement of our tax laws, pointing out those things that operate adversely against both government and taxpayers...Sometimes we do not always agree with you, but we have some reluctance to state the fact that we do not agree with you because of your fine reputation” (AICPA, 1957, p.13).

The drive to improve the profession’s standing and consolidate the AIA’s power as the sole voice of CPA’s was driven mostly by the needs of small practitioners. In the nineteenth century, it had been elite practitioners from the leading firms who had encouraged unity in order to promote their agenda of passing licensing laws and setting minimum standards for CPAs. Local practitioners developed their own client base and saw no need to concede to state and national organizations the right to determine how their practice was conducted. It was partly this disdain for the national organizations by small practitioners that hindered efforts at national unity until the New Deal (Carey, 1970, p.345-9). By the 1950’s, however, the small accounting firm increasingly faced challenges requiring an authoritative and representative voice. An ever expanding set of accounting standards as well as increased automation and cost-tracking techniques

placed more demands on CPAs. Carman Blough's column of technical advice and John Carey's exhortative columns all were geared to providing guidance to the small firm.

The larger, national firms had by the 1950s sufficient resources to conduct their own research and provide technical guidance to their employees. In addition, the work of the national firms dealt with auditing and consulting for the industrial giants of national and increasingly international scope who were publicly traded on the New York and American Stock Exchanges. A merger wave hit the accounting profession in response to the increased scale of international business. "Big 8 accounting firms had to adapt to the internationalization of American business" (Wootton and Wouk, 1992, p.2). This expansion of the national accounting firms reached into the small practitioners' domain as well. National businesses increasingly kept branch offices in smaller markets, and local business wishing to expand also needed national accounting firms to handle their business. Local accounting firms often could not offer continuity of service, as partners could not always train and retain partners to continue serving clients upon the partner's retirement. The national accounting firms could also offer advisory services for expanding business that the smaller firms could not (Wootton et al. 2003, p.34).

Small practitioners particularly resented the poaching of their clients by Big 8 firms when these companies expanded to a national scale and made their first public stock offering. One observer noted: "The local firms face a continuing succession of tragedies as the small and medium-sized companies they have grown up with locally grow too big for them" (Wise, 1960, p.192). There was even a movement to ban the published research being done by Big 8 firms, out of concern that it was burnishing the

national firms' reputations at their expense. The efforts to strengthen the AICPA as a small-practitioner focused organization included a desire to help local CPAs become more competitive with national firms (Wise, 1960, p. 193).

The AIA's focus then, turned away from the increasingly independent national firms and towards the needs of the small practitioners. For while the national firms expanded to smaller markets and to the international stage, smaller firms were growing at an even faster rate. "From 1946 to 1966 the number of CPA's associated with the ten largest firms had jumped from 2,950 to 11,850 - a 401% increase. However, the total number of CPA's had jumped from 20,778 to 94,284 during the same period - a 453% increase" (Carey, 1970, p.356). Several of the presidents of the AIA (after 1957 the AICPA) had backgrounds in local firms, including Robert Witschey (1951), Marquis Eaton(1957), and Clifford Heimbucher (1963).

As the AIA reoriented its mission towards the needs of the small practitioners, it transformed itself into a truly national organization that took responsibility for the standards by which all CPAs worked. The success of their efforts to truly represent the profession were paying off: immediately after the 1937 merger, 4,900 out of 16,500 CPAs in the United States belonged to the AIA (30%); by 1958 31,000 of 56,000 were AICPA members (55%) (Carey, 1969, p.370 , U.S. Congress, 1958B, p.1439).

Among the top of small practitioners' agenda was the encroachment of unlicensed public accountants into CPAs' territory. In the postwar era, CPAs were almost universally college graduates and had passed a now nationally standardized and notoriously rigorous examination process. PA's competed only in local markets, and so

posed little threat to the Big 8 firms. But for small practitioner CPA's, unlicensed public accountants were interlopers who threatened their hard-won status and thwarted goals of professional unity. The AIA's official policy was to encourage public accountants to obtain the educational and statutory requirements of CPAs, something the PA's, not surprisingly, resisted as pointless, bureaucratic hoop-jumping. Although public accountants had their own state and nationwide organizations, anyone could call themselves a public accountant. CPAs major concern was that unethical or untrained individuals holding themselves out as public accountants would damage the reputation of the accounting profession. In a sign that the national organization was moving towards the concerns of small practitioners, it was only in 1957 that the AIA changed its name to the American Institute of Certified Public Accountants, a step explicitly intended to distinguish the licensed public accountant (AICPA, 1957, p.1).

The Institute's new focus did not win universal acclaim in the accounting community. George O. May, now in his third decade of retirement, maintained a vigorous and often cantankerous correspondence with AICPA officials. At times his letters resemble the angry missives that fill the Letters to the Editor section of local newspapers, but they also reflect the generational fault lines that symbolize the profession's development in these years. May's career, from the 1890s through the New Deal, had witnessed the acceptance of the CPA's role as a watchdog of American capital markets, an effort that he as much as any individual was responsible for. Through the 1950s until his death in 1962, he worked on complex accounting issues relevant to the auditing and financial statement preparation for the largest American corporations. His

narrow view of the profession suggests a man who could not see beyond his own experience. From resisting James Landis' efforts to establish legal liability to opposing the AICPA's focus on the needs of small practitioners, he remained a thorn in the side of those who would make accounting a modern profession.

"I deeply regret the appointment of an expert in publicity [John Carey] as editor of the *Journal [of Accountancy]*," May writes to Carman Blough. "It seems to me to be an acceptance of the view that the function of that Journal is to promote the interests of accountants rather than to give accountants professional guidance" (May papers, 58-10, 1956). To John Inglis of Price Waterhouse he continues: "I think it is high time somebody protested against Carey's monopolistic rule in the Institute...Obviously, neither a real profession nor a real professional man should either advertise or be a competitor" (May papers, 58-10, 1956).

Blough, who had been advocating his vision of the profession against May since his tenure at the SEC in the 1930s, is also a focus of May's displeasure: "Carman Blough is a tired man who has lost a large part of his earlier efficiency...I wish I could share the view that [he] has rendered the Institute a great service as its Director of Research" (May papers, 57-1, 1957). It is expressly the focus on small practitioners that May takes issue with: "There is in the research organization neither the will nor the ability to face the problems presented which have to do primarily with the large corporations. This is not surprising, since the membership of those committees is drawn mainly from accountants who have no participation in the auditing of these corporations" (May papers, 57-1, 1957). He concludes: "I like Carman personally and have deep sympathy for him. I

think he has rendered a very useful service to small practitioners by his discussion of the everyday problems that arise” (May papers, 57-1, 1957). But he saw such efforts as cheapening the profession he had helped to build, and degrading the relative value of his work on sophisticated accounting procedures that were largely irrelevant to local practitioners.

Another target of his criticism was the trend among accounting firms to offer their services in the expanding field of management advisory services, or consulting. This work was seen by many as a means of enhancing the CPA’s prestige as a “man of business”, as well as a more profitable line of work than the financial statement audit. Although the Big 8 firms pioneered MAS work in the 1950s, local practitioners also took to it, encouraged by the AICPA. May saw consulting work as a serious conflict of interest and a diminution of the CPA’s role as an independent auditor. Referring to AICPA President Marquis Eaton’s promotion of MAS work, May wrote in a private memo: “In what sense is management advisory service on a higher level than that rendered by the independent accountant on the accounts of a corporation? Mr. Eaton’s answer to this question is clear: that the service is on a higher level of profitability” (May papers, 68-10, 1959). On this issue, at least, May’s concerns were proved right. Over the course of the next several decades, consulting work drew a steadily larger share of firms’ revenue, to the point where many feared that dependence on consulting fees rendered CPA’s unable to stand up to their clients on questionable audit practices. This conflict is generally viewed as being the root cause of Arthur Andersen’s complicity in the Enron scandal.

Perhaps the most revealing statement among May's papers is an undated "Precis for Talk with Mr. John L. Carey" from 1956. Here, May explicitly rejects the notion that accounting is truly a profession at all: "In what sense is accounting now or likely to be in the future, a profession? Accounting as a calling or a profession is an outgrowth of the corporate system. It is concerned with problems of finance, not of personal well-being. It would seem to follow that it is not a profession in the sense in which the word was used 200 years ago. Can it be said to be a profession, entrants to which should have a sense of mission? It is surely not a profession the entrants to which commonly have a sense of mission. The decision to enter it is, I should suppose, generally as it was in my own case, based on a belief that it is a field in which the ability the entrant possesses could most profitably and not uncongenially be employed...Recognition by the state did not bring with it any such broad privileged status as the bar enjoys. There is little incentive to acquire the status of a CPA with a view to entry into any other than an accounting field of activity. There is such an incentive to acquire the privileged status of a lawyer" (May papers, 56-10, 1959). These overwrought (and patently untrue) comments suggest a man flailing for arrows to dart at his enemies. May had come to accounting from a patrician background in England. He had been slated to attend Cambridge before being persuaded to enter accountancy, "the rising profession" as he remembered it (Grady, 1962, p.9). He had risen in the profession through an apprenticeship typical of the English system, and quite in contrast to the more "democratic" system of university education as the path to professionalism that was common in the United States (Bleidstein, 1978, p.33). The profession's expanding

numbers, increasing reliance on formal standards rather than professional judgment, and finally in the postwar era its focus on the rather mundane needs of the small practitioner, all seemed to threaten the elegant “art” of accountancy that he exemplified (see the dedication in Grady, 1962.) His own vision of the profession should not be minimized. He wrote that the work of the CPA “presents one high obligation: a duty to the unknown investor that is superior to the obligation to the immediate client” (May papers, 56-10, 1959). He frequently recounted with pride his public service as a government consultant during World War I. But the CPA of the 1950s and beyond, who engaged in public relations, advertising, and lobbying, was anathema to his model, and something he would continue to fight right up to his death in 1961 at the age of 86.

CHAPTER V

THE UNION CORRUPTION SCANDALS, 1957-1962

The evolution that was taking place in the profession's leadership can be most clearly illustrated by looking at the AICPA's involvement in the union corruption scandals of the late 1950s. What follows is an analysis of that episode.

The AICPA was now firmly in the grip of men who wanted a greater public profile for the profession. The scandals of labor union corruption in the late 1950s offered a forum to announce to the world that "The Auditors Have Arrived", as a profile of the profession in *Fortune* proclaimed. Abandoning an earlier policy of quietly existing above the fray of Washington politics, the AICPA began lobbying in favor of vast expansions of the audit franchise in the field of trade unions and pensions, and to speak confidently of the CPA as business consultant. They did this because they felt compelled by the public attention on the issue of financial improprieties in unions to assert their expertise, not realizing that their long years of avoiding Washington politics left them poorly prepared for this role. Their efforts in the union corruption scandals would be unsuccessful, but the process opened the profession's eyes to the importance of lobbying, and by the mid-1960's the AICPA would be much better positioned to assert its place as a premier American profession.

This new aggressiveness in outlook manifested itself first in the well-publicized union corruption scandals. In 1955 a special Senate Subcommittee, known as the McClellan Committee after its chair, John McClellan (D-Arkansas), began hearings investigating corruption in trade unions. These hearings, best remembered today for the

exchanges between Senate counsel Robert Kennedy and frequent witness Jimmy Hoffa, exposed intimidation, violence, and corruption in the handling of union funds. The hearings showed that a lack of proper financial controls played a role in the corruption: bookkeeping was erratic or nonexistent, union funds were embezzled by bosses, and fraudulent financial statements were presented to the rank-and-file. (Hutchinson, 1970, Kennedy, 1960).

Accounting at this time was one of the nation's fastest growing professions. The number of CPAs in the U.S. had grown from 20,000 in 1940 to 75,000 in 1962, and auditors expected to be "inundated" by even more new business over the course of the 1960s (U.S. Congress, 1962, p.114; Wise, 1960, p.198). But the profession remained largely in the shadows: from 1955-65, the *Wall Street Journal's* annual index had an average of 14 articles under the subject "accounting"; the *New York Times* averaged 12.

The union corruption scandals created a sudden demand for stricter financial controls over unions and pensions. The profession's public image, and in time its jurisdiction as the guardians of financial propriety, could be jeopardized if they did not act aggressively to show the role they could play in reforming unions and pensions. Before the union corruption scandals they had been reluctant to take on new audit clients outside their traditional purviews of Wall Street and Main Street (Miranti, 1990, p.120). But the public uproar over the union scandals convinced the AICPA it was time for a new approach. In addition, unlicensed public accountants also began lobbying for this work, and the AICPA wished to counter this by stating that only licensed CPAs (who had passed the formal CPA exam) could be trusted with auditing tasks (below).

With this in mind, the AICPA decided to involve itself in the debate over labor reform. Their 1958 Annual Report articulated their new position: “The public interest is served by the federal government’s encouragement of independent audits by competent and responsible professional accountants of (a) private institutions or public agencies independent of the federal government which are utilizing federal funds, and (b) of private institutions which are obliged to submit financial reports for federal regulatory purposes,”(AICPA, 1958, p.11). Carman Blough, Director of Research for the AICPA, elaborated on this in testimony before Congress in 1959: “The institute is not a frequent witness before Congress...It has been the policy of our institute up until last year not to make this type of representation before Congress on the basis that, if we appeared on bills of this kind, it would be taken that we were self-serving in our appearance, that the purpose we had in mind was to get more work for CPAs. For that reason, we were very reluctant, for years, to make any presentations of this type. But about a year ago our executive committee reached the conclusion that this was not a sound policy, that where fiscal matters were involved on which we should have specialized knowledge, we should make ourselves available for questioning and should make representations, as I have here today, on matters in which we feel we have particular abilities” (U.S. Congress, 1959a, pp.979, 985). To help foster a closer relationship with the federal government, in 1959 the AICPA opened a Washington, DC office. John Carey, the Institute’s Executive Director during these years, writes that “it gave the Institute a visibility in the nation’s capital which had not existed before,” although he insists “the charge to the Washington staff was not to lobby,” (Carey 1970, p.436).

I. Congressional Reform of Unions and Pensions

In both houses of Congress, several complex bills to regulate unions vied for support. Unable to obtain a consensus around any one comprehensive proposal, and eager to show the public it was accomplishing something, Congress in January of 1959 settled on passing the Welfare and Pension Plans Act, as a prelude to the Landrum-Griffin Act passed later that year. Pensions had become a common employee benefit after World War II. These union pensions “provided...a massive new source of plunder” for organized crime (Hutchinson, 1970, p.138). The pension was frequently held in a separate trust, but in the extreme cases described in the McClellan hearings, the trust was simply a legal fiction (see the story of the United Textile Workers below). Discussion prior to the bill’s passage included the possibility of requiring audits for pensions. The Eisenhower administration apparently supported an audit requirement (Mitchell Papers, Box 180, 1958 F1). A 1956 Senate report explicitly recommended annual audits by independent accountants (U.S. Congress, 1956, p.8). And Carman Blough testified before the Senate in 1957 on behalf of the AICPA. Here was the profession’s first halting attempt at its new strategy.

Blough’s appearance before the Senate Subcommittee on Welfare and Pension Reform Legislation on June 6, 1957 was consistent with the AICPA’s reluctance to lobby. In very professional and articulate testimony, Blough is most concerned with emphasizing that the AICPA is not endorsing the audit proposal, and he is often at pains to explain the limits of an audit: “It is important to know that, while many kinds of financial data can be audited, there are some kinds which do not lend themselves to

verification without going to unreasonable lengths...We do not verify every item. To do so would often be impossible and usually prohibitively expensive...No audit of a fund would be likely to disclose such a kickback,” (U.S. Congress, 1957a, pp.164-5). AICPA President Marquis Eaton also sent a telegram on July 27, 1957 to “The White House” addressed to “The President” supporting the audit provision. The reply is a form letter addressed to “Mr. Eaton” and supports a conclusion that the AICPA had not cultivated relationships with the people making decisions that would impact the audit profession (DDE Central Files, General Files, Box 939, 1957). In the end the pension bill did not include an audit requirement, although it did require pensions with more than 25 participants to file annual reports with the Department of Labor. Pensions in the United States totaled some \$30 billion in 1959, covering more than 75 million Americans, including workers and their dependents (Lee, 1989, p.75).

Later that year Congress would move towards comprehensive union reform. The McClellan Committee hearings created a broad public consensus that corruption in organized labor needed rooting out. The American Federation of Labor-Congress of Industrial Organizations (AFL-CIO), the largest federation of trade unions in the United States, attempted to head off restrictive legislation by cleaning its own house, expelling several unions, including the Teamsters and the United Textile Workers. The AFL’s new regulations included an annual audit by a CPA for all member unions. The AFL did not have the power to enforce an audit requirement on its member unions (and this may well explain why it was so quick to give public support for the measure), but its endorsement of CPA audits, along with that of the National Association of

Manufacturers, gave broad legitimacy to such a proposal (“AFL Code”, 1957, p.51; United States Congress, 1959d, p.1711). In this atmosphere Carman Blough testified again, this time before the House Joint Subcommittee on Labor-Management Reform Legislation, on May 5, 1959.

The AICPA by this time had apparently lost its previous reticence. Testimony on pending legislation in prior years had included the qualification “We do not wish to make any recommendation as to whether an act of this kind should or should not be passed” (U.S. Congress, 1957b, p.164, U.S. Congress, 1958a, p.1439). This time, Blough plainly advocates not only an audit requirement but further urges the exclusive use of CPAs, as opposed to unlicensed public accountants, for this purpose. Raymond Jennison, Executive Director of the National Society of Public Accountants, had testified before the committee two weeks earlier. Their testimony highlights the long-running battle between CPA’s and unlicensed public accountants. As John Carey describes in Chapter 12 of his history, this tension dates from the first CPA licensing law passed in New York State in 1896. As CPA’s consolidated their position through restrictive legislation over the course of the twentieth century, public accountants found themselves increasingly muscled out of the accounting profession. By 1945, they had formed their own organization, the National Society of Public Accountants, and began to parallel the AIA’s (and later AICPA’s) efforts to build a stronger national profile. On the few occasions when CPA’s did testify before Congress, generally on tax and governmental accounting issues, the NSPA often made its own appearance, making similar arguments but asking Congress not to restrict accounting work to CPAs. The mutual hostility

Carey details spilled over into the labor reform hearings. Jennison asks that any audit requirement not be restricted to CPAs, but allow licensed public accountants as well, particularly because “in many small communities they have small locals and actually a CPA is often times not available to them. They would have to travel many miles, and it would be a great additional expense,” (U.S. Congress, 1959b, p.827). He is then subjected to difficult questions regarding the exact differences between a CPA and a PA, and is forced to concede that, besides not being required to pass the CPA exam, PA’s only received licensing from a state board in 28 states as of the date of his testimony.

Blough’s 1959 testimony is notable not only for the AICPA’s evolution in position regarding lobbying but for its glaring lack of preparation. The congressmen were clearly most interested in the cost an audit requirement would impose on unions, but Blough was either unprepared or unconcerned on this point. When a congressman asked Blough to “venture a guess or give us an estimate...just approximately” on the cost of an audit requirement, Blough avoids giving any sort of substantive answer: “That is something on which it would be impossible to make a figure estimate, for this reason: the expense of the audit will vary by the size of the union, the number of its transactions, the orderliness of its records, the amount of special investigation that has to be entered into in the light of individual transactions that may show up in the course of the examination. So it would be impossible to put a price figure on an audit even if we had the size of the individual union before us at the time.” The transcript does not record whether any of the congressmen rolled their eyes at being condescended to in this way. Later in his testimony, when a congressman speculates that “in a union of 100 it would

take a well qualified man at least a month to make a complete audit of expenditures,” Blough is after all able to provide some cost parameters, stating: “I would think that in the case of a union the size you mention, it would be exaggerating it greatly to say that it would take a month to make an examination of that kind of a union. I would say a few days at most would be more likely,” (U.S. Congress, 1959a, pp.983, 986).

Blough also mistakenly says that he did not testify two years earlier on the pension bill, and when asked whether any current laws require a CPA audit, Blough does not think to mention the Securities Acts of 1933 and 1934 (United States Congress, 1959a, pp.984, 991). It is worth asking how someone with Blough’s experience could turn in such a poor performance. Blough was, after all, the first Chief Accountant of the Securities and Exchange Commission from 1935-38. But he had left this post some twenty years before, and since 1944 had been the AIA’s (later AICPA’s) Director of Research. Throughout the postwar era the profession provided expert testimony on taxation and federal government accounting issues on dozens of occasions. There were clearly individuals within the AICPA familiar with providing congressional testimony, but Blough apparently never consulted them. Nor, during the AICPA’s efforts to lobby during the summer of 1957 on the pension requirement, is there any evidence that Blough and President Eaton consulted on how to present a unified message (above). The most likely explanation for Blough’s testimony is that the AICPA was acting defensively on the issue of union and pension audits, responding only as events seemed (in their eyes) to dictate. No clear strategy was ever developed or disseminated through the

Institute. Blough's testimony was an afterthought, and without sufficient prodding, neither he nor anyone else at the AICPA bothered to prepare for his testimony.

Blough's new assertiveness on behalf of the profession was not followed up on subsequently in the union corruption debate. The Institute did make a few other half-hearted efforts on behalf of the audit requirement: AICPA Executive Director John Carey submitted a letter on behalf of the Institute to a Senate subcommittee advocating the audit requirement. The *Journal's* editorial in the wake of the final passage of the Landrum-Griffin Act suggests, just as clearly as Blough's testimony, how far from the political corridors of power the profession's lobbying efforts were. They write: "It is a little hard to understand why the Congress and the Secretary of Labor have failed to adopt a requirement for independent audits", like Blough ignoring the congressmen's concerns about the cost of an audit ("Will Union Financial Reports be Adequate?", 1960, p.27). Ultimately the record makes clear that the profession's efforts had no impact on the final bill. No mention of an audit requirement appears in the two-volume *Legislative History of the Labor-Management Reporting and Disclosure Act of 1959*, and the congressmen generally seemed to not understand what a CPA could contribute. Rep. Phil Landrum, for example, opined: "I am wondering, perhaps, if the reporting and disclosure provision...are [sic] not going to be complete whether or not a certified public accountant performs the task. I think the information called for is so completely set out in detail that it will not make a great deal of difference whether it is a certified public accountant or whether it is just who can add and subtract who puts it down there," (United States Congress, 1959a, p.983).

Whatever confidence the profession had engendered was surely not helped by the story of the United Textile Workers of America, a union with 50,000 members and approximately \$900,000 in annual member dues in the 1950s (U.S. Congress, 1957b, p.3334). In testimony before the McClellan Committee, widely reported in the press, detailed and often pointed questioning by committee counsel Robert Kennedy elicited a sorry tale of the President of the UTW spending tens of thousands of dollars of union funds on personal expenses, including \$11,411 for theater tickets, over a period of several years (See particularly NYT 7/20/57, p.7). Throughout this time, the UTW had employed a CPA, Eric Jansson, who had annually audited the union books, presumably with the understanding that he would not ask too many questions. (To document \$13,000 in “organizational expenses”, Jansson prepared a report listing the money as being used for the “Canadian situation” (U.S. Congress, 1957b, p.3325). Besides McClellan, the senators present for this testimony included John Kennedy, who would become a leading figure in the Senate on labor reform legislation and had as large a role as any congressman in the final bill. Use of the term “certified public accountant” occurred with mortifying frequency. At one point, Senator Barry Goldwater asks Jansson:

Senator Goldwater: Have you ever made recommendations to the president or the secretary-treasurer that they tighten up their constitution in relationship to money?

Mr. Jansson: No, sir.

Senator Goldwater: Let me ask you this: is that not an ordinary function of a certified public accountant? (U.S. Congress, 1957b, p.3331).

It would not be surprising if the senators concluded that involving CPAs would be of little help in trying to clean up the unions.

The final legislation, the Labor-Management Reporting and Disclosure Act, signed into law by President Eisenhower on September 14, 1959 and also known as the Landrum-Griffin Act after its two co-sponsors, did not include an audit requirement. The papers of President Eisenhower's Labor Secretary, James Mitchell, suggest that cost was the chief concern. The two congressmen who had proposed an audit requirement, Senator William Knowland (R-Ca) and Rep. Graham Barden (D-NC), were considered anti-labor and their proposals were characterized generally by Mitchell as being too harsh. Eisenhower himself told Mitchell he did not want the legislation to be harder on labor than the government was on management. Mitchell responded by briefly mentioning the SEC's authority over corporations, though he does not seem to have had in mind an analogy between the Securities Acts of 1933 and 1934, which required annual audits of all publicly traded companies by independent accountants, and the proposed labor legislation. In fact, in the only direct reference in Mitchell's papers to the audit requirement, an aide writes Mitchell that it would "set a precedent which might be embarrassing in other cases," apparently unaware of the Securities Acts. Finally, the aide concludes that simply filing unaudited financial statements with the Department of Labor would be as effective as an independent audit (Mitchell Papers Box 107 (1958), B173 (1958), B177 (1959), B180 (1958); DDE Papers as President, Leg. Mtg Series, Box3).

II. The Impact of Landrum-Griffin

Had the union audit requirement succeeded, a real possibility in the summer of 1959 despite the profession's ineffectual efforts, accountants would have found themselves with tens of thousands of new audit clients. A similar result would have come from an audit requirement in the Welfare and Pension bill of the previous year (Wise, 1960, p.158). No doubt the potential impact of these bills on unions and pensions was in part what motivated the AICPA to involve itself in the debate, but the haplessness of their efforts suggests they had made no real provision to prepare for the massive potential new business of unions and pensions.

Besides the potential impact of these bills on the accounting profession, both unions and pensions could have benefited tremendously from independent audits. Unions, in fact, are arguably still in need of the profession's skills. There remains today no requirement that unions undergo outside audits. As of 2000, only 63% of active unions with annual receipts in excess of \$200,000 received audits by outside accountants (<http://www.dol.gov/esa/regs/compliance/olms/rrlo/lmrda.htm#1>). A 2002 report by the House Committee on Education and the Workforce concluded: "The Department of Labor under both Republican and Democrat administrations has been very lax in its enforcement of the existing reporting regulations," (U.S. Congress, 2002, p.6).

It would be sixteen years before the Employee Retirement Income Security Act (ERISA) in 1974 required annual audits of pension plans by independent accountants. In 1956, a Senate committee found that "a great many of these plans are sorely lacking in adequate accounting procedures...It is the exception when welfare and pension programs provide for an accounting to or an audit on behalf of the beneficiaries," (U.S.

Congress, 1956, p.6). A 1972 Congressional study found that only 48% of all pension plans in their sample had independent audits. The study was a statistical sample of plans reporting to the Department of Labor. Of this sample, 91% of plans had fewer than 1,000 participants; of these, 46% had independent audits. It is also worth noting that 93% of the plans in their sample had assets totaling at least 25% of accrued benefits (U.S. Congress, 1972, p.29). Of course, the reforms of both unions and pensions involved not only financial statement audits but legal efforts and regulations put in place over decades, processes detailed by several historians (See Bellace and Berkowitz 1979, Estey et al. 1964, and McLaughlin and Schoomaker, 1979). This paper does not claim to judge the effectiveness of the Landrum-Griffin Act, the Welfare and Pension Plans Act, or ERISA. For accounting historians' purposes, it is the AICPA's decision to involve itself in the debate that is of interest.

The AICPA continued to become more assertive in its appearances before Congress. By 1962, the AICPA's attitude towards active lobbying had undergone a virtual transformation. Many authors have documented the profession's increasing involvement at this time in providing consulting services for audit clients. At a hearing on the needs of small business, Robert Witschey, nominee for president of the AICPA, promotes the CPA as business advisor: "The traditional functions of the certified public accountant have been the independent auditing of financial statements leading to the expression of an opinion as to their fairness, and consultation on tax problems. After World War II, however, it became apparent that one of the most important needs of small-business management was assistance in areas where the training and experience of

CPA's gave them special skills." Witschey further relates a study that found CPA's are the most sought-after outside consultants among small business manufacturers (U.S. Congress, 1962, p.113-4). Gone are Carman Blough's qualifiers about the AICPA not wanting to appear self-serving.

The AICPA made a determined effort in the late 1950's and early 1960's to expand the profession's numbers and business, and to take a more prominent place in American society. At the time, it probably considered its previous, diffident stance to be naïve and antiquated in an expanding economy. Though they did not secure audit requirements for unions or pensions, failures with very significant repercussions, they would get better at making their case in Washington. Over the course of the 1960's they would begin reaping the benefits of their fledgling effort in the union scandals, as CPAs secured recognition to practice before the Treasury Department on tax matters in 1965 and federal government agencies increasingly hired CPAs (Carey 1970, p.257, 437). More consequential was the profession's abandoning the image it had so carefully cultivated since the New Deal. The auditor who quietly but faithfully served the small investor, who "let in the light", in FDR's phrase, on the nation's big businesses, gave way to the man of business eagerly promoting his expertise and the countless ways it could be utilized. Public accountancy had decisively turned towards becoming an interested profession.

CHAPTER VI

CONCLUSIONS

Over the coming decades, the AICPA's focus on the interests of small practitioners would contribute to a void in leadership for the profession. The Big 8 firms (who later merged into the Big 6, and, eventually, the Big 4), increasingly isolated from the Institute, began taking fewer public stances on controversial accounting issues, in part out of fear of losing important clients in an increasingly competitive market for accounting services (Zeff, 2003a, p.200). The corporate merger wave of the 1960's put accounting standards regarding consolidations in the spotlight, and gave corporations a new interest in pressing their auditors for favorable treatment (Chatov, 1975, pp.199-207). Ray Ball, the most influential accounting researchers of the past half century, recently concluded: "Anecdotal evidence suggests that over time auditors have drifted away from a skeptical, adversarial interaction with clients toward a cooperative approach" (Ball, 2009, p.284). For their part, the AICPA continued to advocate for its membership. The Institute's first tentative steps at lobbying Congress during the union corruption scandals led to the development of a well-funded and largely successful presence in Washington (Coffee, 2006, pp. 216-7).

The growing market for consulting services helped fuel the profession's aggressive new outlook. A business model dependent on audit and tax services became less tenable as accounting firms pursued new clients through price competition. Financial statement audits, a traditionally low-margin business, began to take a back seat to more lucrative consulting work (Zeff, 2003b, p.269). With the decline in value of the

profession's flagship service and a more competitive ethic permeating public accountancy, public criticism from a newly interested press and from Congress became the norm beginning in the late 1960's. One accounting historian concluded: "By 1980, a deterioration in professional values appears to have set in" (Zeff, 2003b, p.267). Zeff's assessment is tame in comparison to that of a 1976 congressional report: "[We find] little evidence that [the Big Eight firms] serve the public or that they are independent in fact from the interests of their corporate clients" (U.S. Congress, 1976, p.4). Consulting work for audit clients continued to expand to the point where it dominated the business models of the Big 8 firms. As George May had warned, the Institute had become an advocate for its members rather than an arbiter of accounting practice, and was unable to provide leadership on the complex accounting issues facing the big firms. The ethical conflict of depending on consulting work from an audit client would not be addressed until the 2002 Sarbanes-Oxley Act, passed by Congress in the wake of the Enron scandal, and characterized as "the most substantial increase in the regulation of U.S. public financial reporting in 75 years" (Ball, 2009, p.278).

Enron also revealed the dubious relevance of accounting research, which was almost completely blindsided by the scandal, and even dismissive of repeated warnings from regulators in Congress and the SEC. As late as 1999, a respected audit researcher huffed: "[The SEC] questions whether the public will mistrust financial reporting when CPAs also collect substantial fees for their other assurance and consulting services rendered to audit clients. While frequently expressed by regulators, there is remarkably little evidence that investors are concerned about such services" (Kinney, 1999, p.73).

As noted in Chapter I, prior to the Enron scandal accounting research had found no evidence that providing audit and consulting services for the same client hinders transparent financial reporting (Kinney et al., 2004, p.563). Even in several studies since, research has been unable to provide a clear link, and in fact the prevailing hypothesis continues to be that consulting work actually improves the quality of the audit, by providing the auditor with additional expertise on the client's business (Ball, 2009, p.296; Kornish and Levine, 2004, p.173).

The inability of mainstream accounting research to predict or even retrospectively explain Enron presents an opportunity for the reemergence of accounting history research in the U.S. While a vibrant field abroad, accounting history has for several years been on the decline in American accounting research. As Fleishman and Radcliffe (2005) write: "The field's prospects in the U.S. seem to be diverging from the promising conditions seen in much of the rest of the world...even at American institutions whose leading faculty are accounting historians, it has long been very difficult to secure doctoral training in which accounting history would be the core of scholarship." They conclude that we may be witnessing "the quiet but discernable death of accounting history in the U.S." (Fleishman and Radcliffe, 2005, pp.83-6).

An often uncertain agenda may in part explain the field's decline in the U.S. Over the past two decades, accounting history research has dealt with its own unique iteration of the postmodernist debate familiar to historians. An attempt to incorporate "less visible participants in the accounting function itself" and to explore "the partisan nature of accounting records and methodologies through which accounting practices can

be deployed to suppress classes of people” has divided accounting historians into postmodernist and “traditional” camps (Fleishman and Radcliffe, 2005, pp.68,73). Traditionalists, also termed “neoclassical”, tend to follow a Whig history of “how accounting innovation has led to the economic betterment of a business entity”, and how the sophistication and professional standing of accounting has grown alongside an industrial economy (Fleishman and Radcliffe, 2005, p.71). While postmodern studies have arguably led to a resurgence of a more normative stance regarding the effects of accounting practice beyond the narrow constituency of investors, its potential may be limited. The postmodernist insight that accounting information may be used as a tool of hegemony by corporate managers does not necessarily alter the basic storyline of accounting aiding in the efficient functioning of a business. Further, the studies that have been done of traditionally marginalized groups in accounting have been of limited value. An excellent example is Wootton and Kemmerer’s (2000) study of the experience of women in the American profession. The hiring of women in large numbers by accounting firms, a process that began in World War II and developed slowly over the next thirty-some years did not alter the profession in any discernable way. The constituencies served by accounting information have remained unchanged since stockholders displaced banks in the early part of the 20th century as the primary audience for financial statements.

My own study cannot be said to have benefited from a postmodernist perspective, although I would also question whether it can be classified as Whig history. While I do describe the changes that the accounting profession experienced in the mid-

twentieth century as an evolution, these changes had both good and bad consequences. The democratization of the profession led to a broader understanding by the national leadership of the obligations of CPA's in the American economy, as evidenced by their willingness to take on new responsibilities, and new legal liability, in the union corruption scandal. But it also started the profession down the road of the CPA as a "man of business", an advisor whose expertise could expand beyond the audit function into consulting. As we have seen, this would compromise the CPA's vaunted independence from management, the ideal that the New Dealers had worked so hard to instill in the profession.

The profession's troubled history in the half century since the union corruption scandals suggests that professional self-regulation leads to advocacy more than regulation. Competing for business inevitably leads to the marginalization of ethical responsibilities. This has proven true of the American legal profession as well as accounting, as corporate lawyers were replaced by in-house counsel and the "Brandeisian ideal" of the lawyer-statesman became an anachronism (Coffee, 2006, pp. 199-202). For accountants, the brief period emphasizing the societal responsibilities of the CPA ended almost as soon as it began. Professionalizing the nation's CPAs by bringing them all under one banner created an us-vs.-them mentality characterized by defensively protecting their professional turf, creating a profession that even accounting historians struggle to defend. It may be that the fear that haunted the New Deal generation, of a government takeover of corporate auditing in the mold of federal health inspectors, is the only means of ensuring a disinterested profession.

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