

American Accountancy, An Overview, 1900-1925

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Within the last several years there has been a resurgence of interest in the development of American accountancy. In part, recognizing this growing interest among business, economic, and accounting historians this paper will focus on the dimensions of financial accountancy during the years 1900-1925. The general questions which will be answered by this paper cover a range of "the what, when, and why" of how early CPA leaders of accountancy were able to establish the first legislatively sanctionable business experts in a modern business environment.

The years around the turn of the century through World War I constituted the age which felt the initial impact and consequences of American industrialization. Technology and manufacture advanced at a pace never before achieved. Change and growth were rapid and had to be faced by the executive and the accountant without benefit of historical precedent. People were drawn to the urban industrial areas to such a degree that by 1920 the Census revealed that for the first time more Americans lived in urban areas than rural.

Significant political events marked these years. The death of Queen Victoria of England in 1901 signaled the passing of an era of reserved propriety just as the assassination of President McKinley that same year opened the way for the personality politics of Teddy Roosevelt [18, p. 309]. In 1908 Taft succeeded his protégé Roosevelt but by 1912 the politics of adjustment had set in and Woodrow Wilson was elected to succeeding terms on a progressive platform [11, p. 141]. World War I plunged the United States headlong into a world economy it had entered less spectacularly a generation earlier causing individual and economic adjustments of a type never before experienced by Americans [22, p. 545]. By 1919 at the close of the war period, the 18th Amendment (Prohibition) was ratified and in the following year women's suffrage was recognized with the passage of the 19th Amendment.

The size of business enterprise during these years led to a need for large amounts of capital which in turn required financing on an unprecedented scale. Industrialists and investment bankers,

gaining control of a large segment of the economy, aroused the public's fear. Big government was called upon to preserve a competitive norm which reflected the traditions popularized in agrarian America.

Overall the economic and social events of this period fashioned the institutions of our modern way of life. The effects which the growth and changes in the conditioning environment of the period had on the development of 20th century American accounting, its function and theory, now need to be considered.

THE CPA MOVEMENT

With the passage of an 1896 state law in New York, the profession of certified public accountancy was begun. Although sophisticated practitioners, both native-born and from England, had existed in the form of professional groups, they lacked the legal stature to begin to build the uniformity of education, training, and practical expertise in their service which are hallmarks of other professions. Just the changes which grew out of the environment of the early 20th century had caused economists to restudy their doctrines, so this new industrial epoch placed unique demands on accountancy. An editorial which appeared in the January 1900, issue of *The Public Accountant* (Pennsylvania) [17, p. 19] describes the trusted position attained by accountants at the dawn of the new century.

At no time in our history has such great prosperity been known in this country. Money is plentiful and manufactures and trade are springing into new life all over the country. The revival . . . and the great prosperity has had its effect very considerably on accountants. The starting of new business enterprises has caused them to be retained in cases larger and more important than ever before.

The profession is slowly, but surely forcing itself into its proper place among the other professions and is becoming known to the manufacturer, to the merchant and to the banker and financier. Such a state of affairs was comparatively unheard of . . . that a new enterprise, involving millions of capital, should retain a Public Accountant even before its counsel, yet such is the case and it is not a single case either. Were we at liberty to do so, we could state case after case in which the accountant was the trusted advisor of the promoters of the largest business combinations the world has ever seen.

Written a year before the formation of the United States Steel Corporation, these remarks bear out the important advisory function which accountants were called upon to perform during the era of consolidations.

There were less than 250 CPAs in America at the beginning of this century. By 1920 over 5,000 original certificates had been issued, with those from New York, New Jersey, and Pennsylvania accounting for about one in every four [8, p. 362]. In attempts to harness this surge of growth, accountants formed professional associations, including the American Association of Public Accountants and the Federation of Societies of Public Accountants in America, which merged in 1905 and became known as the American Institute of Accounting in 1917 [2, p. 277].

The young American profession, lacking the depth of experience, borrowed theoretical premises and procedures from the British who had pioneered the professionalization of accountancy a few decades earlier.

In England accountants were trained by a strict apprenticeship routine which required that the aspirant be "articled" with an established accounting firm. When it became apparent that British methods were not fully suited or adaptable to American ways, the latter were quick to establish their own standards [19]. For example, under New York law a certificate was issued only after successful completion (waivers ignored) of the four-part CPA examination covering accounting theory, commercial law, auditing, and practical problems. Five years of accounting experience was required in addition to a high school education and certain moral, character, and citizenship qualifications.¹

The rigorous nature of the CPAs' educational standard can be appreciated relative to typical levels of formal education at that time. For example, in 1900 the median level of schooling attained in America was 7.9 years; by 1910 this figure had increased to 9.7 years, and by 1920 the level had reached 10.1 years -- still well below the minimum requirement set for admission to the profession as in New York [7, p. 208].

A CONDITIONING ENVIRONMENT FOR THE CPA MOVEMENT

The advent of CPA legislation advanced by "model laws" promoted by professional groups afforded the CPA a substantial prestige. It represented a level of competence and ability not otherwise determinable among the mass of individuals calling themselves accountants. The solidifying professionalism of the certified public accountant is a distinctive accomplishment of this period of business history. To be sure, management (internal) accountants and governmental accountants functioned then as now, yet their role lacked legal recognition and the status which the CPA had earned.

In this paper then, American accountancy during 1900-1925 is described principally from the view of a profession led by the CPA as auditor and expert in the field of financial information and reporting.

Let us look at some significant factors which the practicing accountant contended with in his financial practice during this period.

Collegiate Accounting Curricula

Although college work in accounting was not yet a requirement for the certificate, the need to expand college level course work in accounting became apparent to leaders of the early profession. Acceptance of accountancy as a subject in collegiate business programs was an accomplishment of this age. In 1900 there were no American colleges which recognized accounting as a major field of study for a bachelor's degree. By 1920 over 40 institutions were offering accounting as a major concentration [1, p. 166].

A distinctive feature of early accounting education at the undergraduate level was its practical orientation. Accounting instruction, as a result, tended to represent an explanation of what was currently being done in practice, serving to explain basic procedures long relied upon by the working accountant [9, p. 3].

Price Level Disparity

The fluctuating value of the dollar is not a unique post-World War II phenomenon. From the close of the Civil War until 1897 there was a continual fall in commodity prices and a corresponding deflation, interrupted only by a slight reverse trend between 1879 and 1882. From 1897 to 1920 there was a countering rise in commodity prices and inflation [12, p. 20]. By 1910 the 1900 dollar had depreciated 17 percent and by 1920 the 1900 dollar was worth only 40 percent of its original value. This represented a greater inflation than that experienced between 1940 and 1960 [4, p. 110].

This duodirectional change in prices created increasingly difficult valuation questions for accountants which were further complicated by the problems of obsolescence, which had appeared in the wake of tremendous technological advances [21].

The "Economic Man" and Accounting

The dawn of the 20th century found the works of Mill and Marshall in the main stream of popular economic thought. Account-

tants had become familiar with the classical brand of economics through training or experience so that if early 1900 accounting thought was influenced by a body of economic doctrine, it was probably the classical variety supplemented by the works of Marshall and perhaps Taussig. The suggestion of accounting and economic thought association is not made for the purpose of proposing an intense research of the relationship but to acknowledge by inference where accounting theory demonstrated affinity to popular economic premises. An important example of this is related to the classical assumption known as the "economic man," which suggests that a primary motivator of man in the economic milieu is the desire to maximize gain. It seems warranted to assert that the attention given to "profits" and its increasing importance to accountants of the period even before the income tax law resulted from a recognition and acceptance of the tenets of this assumption as reflected in a corresponding emphasis on profit determination as a most important aspect of accountancy in an industrial society.²

The Accepted Degree of Financial Disclosure

The existing "Blue Sky" securities statutes of this period suggest that investment regulation and financial reporting matters were generally deemed to be matters of state concern despite the fact that state control was subject to question in terms of uniformity and effectiveness [10, p. 161]. Weak state laws, loose security distribution methods, and the absence of definite accounting standards contributed to the dissatisfaction of stockholders, aggravating a basic discontent caused by inadequate reporting and acting to preserve well into this early 1900 period the mode of secrecy surrounding corporate financial disclosure. The continuing acceptance of secrecy acted as a channeling influence on accounting's functional scope, focusing disclosure patterns on internal management needs more than on the needs of external parties such as investors and stockholders.

Income Tax Legislation

Perhaps more than any other single event, tax legislation brought professional accountants into regular contact with new clients [14, p. 230]. The income basis for taxation required a complete and permanent record of the business's financial history. Such a formal data requirement was comparatively new for many businesses (taxes had heretofore been levied on a stock-in-hand basis) and tested accountants' abilities with regard to the principles of economics and business procedure as well as their knowledge of the specialized body of tax regulations. In short, income taxation established a demand for an experienced and qualified

business specialist to gauge the adequacy of the accounting systems of a business and the results therefrom [15]. In this way the accountant's function as tax adviser to the businessman and as consultant to the government, aiding in the development of regulations, was fashioned.

Just as the advent of income taxation broadened the range of accounting functions, so it served to sharpen the need being felt for conceptual guidance in achieving compliance with the general goals set out in an income-based system of taxation. For example, a 1918 regulation [3] stated "Approved standard methods of accounting will ordinarily be regarded as clearly reflecting income." (Article 23, Reg. 45, Act of 1918) Such vague specifications for income determination marked another reason for formulating a structure of accounting concepts which would be relied upon to provide a more genuine consideration of the facets of income determination.

Requirements of the War Effort

Contact between accountants, government officials, and financiers was heightened by the activity of World War I. One important example of how the war effort shaped the scope of accounting's audit function was the engagement of an accounting firm by J. P. Morgan and Company. Morgan was acting as the munitions purchasing agent for the British and French governments, and engaged Arthur Young and Company, a leading public accounting firm, to audit the shipments and voucher payments in connection with contracts involving several companies. "This engagement was significant," James Don Edwards says, "because it became the first and largest audit conducted with . . . detail under modern business conditions" [8, p. 106].

In similar fashion accountants throughout the country were being pressed to update and modify the audit function within the frame of big business's transactional volume, not to mention the exigencies of war. Citing these factors Walter A. Staub [20, p. 10] mentions that

There developed the necessity for making the audit one of selected tests of accounts rather than an endeavor to examine all transactions of the period

One result of this development was more and more emphasis on the accountant's review of the manner in which the management had dealt with the recording and classification of transactions of the company from the standpoint of sound accounting principles and the consequent dependability of the determination of income and presentation of financial condition.

Case Law

Audit and advisory responsibilities dominated accountants' activities during the first years of this century but the import of a third duty encompassing an attest function to provide third parties (individuals and government) with impartial information about the financial condition of a company was gaining recognition. A factor which tempered the advance of attest responsibility was case law which supported a contract view of accountants' liability similar to that held in British law.³ As late as 1919 the contract principle was reaffirmed, effectively limiting accountants' responsibility to third-party investors. The particulars of the 1919 suit named Lybrand, Ross Brothers, and Montgomery as defendants. "A third party investor, alleging negligence, had sued to recover a loss suffered in purchasing stock in reliance on a financial statement certified by the firm" [6]. The court held that since there was no contractual relation between the plaintiff and defendants, they owed no duty to the former; therefore, there was no cause for action for negligence.

Without a clear case precedent establishing accountants' attest responsibility with regard to investors there were few external pressures upon the profession or its clients to modify statement disclosures to include information which would be of particular value to interested investor parties.

Proposals for Federal Regulation of Accounting

Federal efforts to regulate accounting, to include rudimentary prescriptions of expense classifications and statement formats had progressed gradually since 1894 with the systems of large public utilities and trusts being the primary object of governmental concern.⁴ Not until 1917 did federal agencies exhibit significant interest in attempting to remedy the problem of inappropriate standards with regard to a broad third-party group. In conjunction with a pronouncement by the Federal Reserve Board calling for certification of statements supporting the application for discounting commercial paper, the Federal Trade Commission's first chairman proposed a sweeping plan to standardize statement forms and audit procedures as well as a program requiring the registry of public accountants on a national basis [8, p. 134].

Although most of the aspects of this ambitious plan were not achieved, the commission, with the American Institute and the Federal Reserve cooperating, did issue a monograph containing tentative proposals for audit procedures and statement formats to be used in preparing the balance sheet and income statement. First titled "Uniform Accounts," the publication was later named "Approved Methods for the Preparation of Balance Sheet Statements," and became a widely recognized procedural guide. Nicknamed the

"accountant's bible," this first attempt to standardize accounting on a national scale achieved a distribution of about 65,000 copies before it was revised and retitled in 1929 [13].

An important object lesson of this episode was the realization that the task of establishing standards for financial accounting was much easier to propose than to accomplish. The heroic plan initially submitted by government officials presupposed the existence of a structure of fundamental accounting principles when in fact such a design had not yet been formulated. The impotence of uniformity attempts at this point of accountancy's development served to reemphasize the importance of seeking to set out a group of fundamental accounting concepts, a recommendation that many leaders considered foremost in plans to advance the effectiveness of professional service.

SUMMARY AND CONCLUSION

The economic and social ferment of the early 20th century had a significant effect on the types of financial accounting duties undertaken by preclassical accountants. At the outset auditing as a preventive and detective procedure was the widely recognized function of the accountant qua professional. Audit expertise led to accountants being selected as trusted financial advisers and consultants during the era of industrial combination. When public concern over disparate ownership and management became apparent in the rising progressive political mood, professional accountants promoted wider use of the attest function by expanding the scope of certified financial statements. Although auditing and consulting remained the principal functions, by the end of the 1900-1925 era the emphasis was gradually shifting, with growing importance being attached to the multiple aspects of the attest responsibility. In advance of this changing emphasis, leading accountants had convinced executives of many large corporations to adopt a fuller disclosure posture with regard to financial information. US Steel, Equitable Life, and General Motors, among others, led the departure from the common attitude of secrecy.

First, it took the form of stronger and growing professional organizations on the state and national levels. Through legal recognition afforded by laws which regulated the admission to and use of the "CPA," the early professional leaders were able to control the size and direction of the CPA movement -- although research currently taking place makes it clear that there was a diversity of opinion among such leaders as to the appropriate size and direction to be taken.

There were by 1925 over 5,000 CPAs. Growing numbers of universities were including accounting as part of their pragmatic curriculum. The technical literature of accounting began to flour-

ish, with the advent of the *Journal of Accountancy* in 1905 and with the growing market for textbooks on a college level.

Professional associations moved, by efforts to establish their own codes of ethics, to regulate themselves, fending off attempts at federal licensure and examinations of accounting and the financial reporting process.

The CPA emerged from this period as the leading image of accountancy. This was the era in which certified public accountancy established itself as a vital service to the business community and to the general public as well, thereby advancing its claim for widely acknowledged professional status.

NOTES

1. [16]. By 1920 all states had passed legislation except New Mexico.

2. The "individualistic" emphasis of classical economics is also reflected in the "personalistic" and "proprietary" duality premises of accounting during the years. Yet as John Bennet Canning, a critic of accounting theory remarked, "There seems to be a popular impression that accountancy is a branch of economics. Without materially enlarging the usually expressed scope of economics this impression might be difficult to justify. Fortunately little or nothing depends on this decision" [5, p. 4].

3. The duties of British accountants were set out in specific legislation known as the Companies Acts. American accountants, however, had no such guide with regard to the limits of their legal responsibilities beyond extant case law which tended to follow British precedent. But American practice was not comparable with British in the basic sense that the former's services were not required by law and therefore were more purely demand-derived. Such a disparity was not described in the suits filed against American accountants. Although the leaders of the profession were advocating acceptance of attest responsibility, accountants who adopted a purely business point of view about their practice probably welcomed the court decisions which limited their chances of being sued by another group, even though this somewhat selfish view served to undermine claims that accountancy was a true profession motivated by its concern for the common good.

4. Railroads first came under uniform account rules in 1894 when the Interstate Commerce Commission issued its classification of operating expenses which was later revised in 1901. In 1907 following the Hepburn Act, the commission's authority was extended to include required standardization of reporting for railroads under its jurisdiction. On the state level, the New York Public Service Commission, formed in 1908, issued a number of uniform account prescriptions for gas, electric, telephone, and street railway companies. Not until the Transportation Act of 1920 and

the issuance of regulations by the Federal Power Commission in 1921, however, was regulatory action deemed to have been sufficiently strong to bring about a noticeable change in the information reported to utility shareholders (see [3]).

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