

EDITORIAL

“Intermediate” and “Advanced” Accounting: The Role of “Economic Consequences”

In a previous Editorial, I argued that theory should play a much larger role in the teaching of “intermediate” accounting [Zeff, 1979]. Of equal concern, in my view, is the recognition in “intermediate” and “advanced” accounting courses of the place of “economic consequences” in standard setting.

If one may judge from the textbooks available for adoption, accounting practices have traditionally been explained in terms of “the accounting model.” In virtually all of the textbooks, the “model” has dealt with the matching of costs with revenues in order to arrive at a proper measure of income. Recently, the emergence of the decision usefulness approach to accounting theory has led textbook authors to refer more copiously to the possible uses of accounting information, although it is not clear that this reorientation has led to different policy recommendations. Undoubtedly, the publication of two influential monographs [AAA, 1966; AICPA, 1973] has accounted for much of the jargon of decision usefulness in financial accounting textbooks.

In the last 20 years, however, evidence has been abundant and well-publicized that considerations other than “the accounting model” have figured importantly in the setting of accounting standards—and are frequently invoked as powerful reasons why extant standards should be changed. Yet “intermediate” and “advanced” accounting textbooks are largely silent about the role which these forces have played, and continue to play, in accounting debates.

There is little need to rehearse the myriad “political” factors which have intruded in the setting (and subsequent criticism) of standards in such areas as the investment tax credit, the implicit discount in convertible debt, business combinations and goodwill, leases, research and development costs, foreign exchange, restructuring of troubled debt, oil and gas accounting, and accounting for the effects of changing prices. The literature offers ample testimony to the fact that considerations other than “the accounting model” have played a heavy role in the policy-level debates preceding, during, and following the setting of standards in these highly controversial areas. But the readers of “intermediate” and “advanced” accounting textbooks are led to believe otherwise. That these textbooks explain extant accounting practices almost solely in terms of “the accounting model” permits the inference that the comings and goings of accounting practice can be comprehended by reference to the “model” alone.

It is my aim in this Editorial, first, to review the textbooks themselves, second, to speculate on the reasons why “economic consequences” occupy such a miniscule place in the textbook literature, and, third, to argue for a course of reform.

I conducted an examination of the six "intermediate" textbooks carrying copyrights of 1978 or later, and of the eight "advanced" textbooks with copyrights of 1978 or later. In the "intermediate" books, I looked at the authors' discussions of three accounting problem areas in which "economic consequences" were indisputably at play: the investment tax credit, oil and gas accounting (full costing versus successful efforts), and the restructuring of troubled debt. The circumstances in which the standards were set are well known; indeed, they have been widely celebrated in articles appearing in *Forbes*, *Business Week*, *Barron's*, *The Wall Street Journal*, and other places.

The "intermediate" books were Meigs, Mosich and Johnson [1978], Welsch, Zlatkovich and Harrison [1979], Kieso and Weygandt [1980], Ellis and Thacker [1980], Nikolai, Schroeder, Bazley and Reynolds [1980], and Davidson, Stickney and Weil [1980]. They are here abbreviated as MMJ, WZH, KW, ET, NSBR, and DSW, respectively.

On the investment tax credit, MMJ mention the "strong opposition from the business community" to APB Opinion No. 2 and the "strong pressure on Congress by some business groups" in 1971 [p. 490], but they provide readers with no clue why such "opposition" and "pressure" were brought. It certainly was not because of disagreements over "the accounting model." WZH write that "The [APB] lost the battle in the political arena" [p. 497], yet they do not inform readers that the aggressors in this accounting combat had absolutely no regard for "the accounting model." Nor do they reveal why accounting debates are waged in a "political arena." In KW, readers are told that "Such strong resistance to [APB Opinion No. 2] resulted" that Opinion No. 4 had to be issued [pp. 535-536]. The intervention of the SEC is not disclosed. Moreover, the basis of the "resistance" is not stated. KW then allege that Congressional action in 1971 "sets a dangerous precedent" [p. 536]. Again the issues are not disclosed, and the heavy involvement of corporate managements (and the Treasury Department) is nowhere mentioned. ET [pp. 327-330] and DSW [paras. 20.41-20.57] treat the subject as if nothing unusual had happened. NSBR twice mention "political pressure" [pp. 367, 369], but the only indication of the source of such "pressure" appears in an ostensibly innocuous sentence: "An argument [in favor of the flow-through method] is that the intent of the investment credit is to encourage investment by reducing tax expense in the period the asset is first used" [p. 367]. Yet the "economic consequences" implications of this argument are nowhere brought out.

While WZH [pp. 704-706], KW [pp. 620-621], ET [pp. 583-585], and NSBR [pp. 521-525] all discuss the restructuring issue, none reveals that the banking industry fiercely opposed the FASB's method of "retrospective" loss recognition; the entire set of "economic consequences" is ignored. MMJ report that "creditors (particularly banks) opposed this proposed standard" [p. 630] but do not explain why. DSW [para. 17.91] perform the best on this topic: in a succinctly written paragraph, they state the banks' position, suggest why the FASB might have been impressed with the argument, and identify one of the major issues to be pondered.

On oil and gas, WZH [pp. 526-527] discuss the issue but (oddly, in view of the location of the authors' university) say nothing of the motives of those who pressured the FASB and SEC for a full-costing standard. To their credit, KW refer to the "public interest standpoint" of governmental agencies such as the Departments of Justice and Energy, and they briefly explain the "economic consequences" of direct interest to those two agencies [p. 539]. On the same page, a footnote mentions "economic consequences" as "an added dimension to accounting standard setting." Even though the treatment is quite brief, it was the only reference I could find to "economic conse-

quences" by name in any of the "intermediate" and "advanced" textbooks. MMJ treat the subject almost in passing, and "economic consequences" are not broached. Astonishingly, ET do not discuss oil and gas accounting at all. NSBR, in their section on oil and gas accounting [pp. 375-376], do not suggest the presence of "economic consequences." The same can be said of DSW [paras. 14.7-14.40].

In the "advanced" textbooks, I reviewed the authors' treatment of business combinations and foreign exchange—two areas where the "economic consequences" dimension has been extensively covered in the financial press and in professional and academic journals.

The "advanced" books were Fischer, Taylor and Leer [1978], Beams [1979], Bedford, Perry and Wyatt [1979], Cameron, Woelfel and Pattillo [1979], Haried, Imdieke and Smith [1979], Meigs, Mosich and Larsen [1979], Griffin, Williams and Larson [1980], and Jensen, Coffman and Burns [1980]. They are here abbreviated FTL, B, BPW, CWP, HIS, MML, GWL, and JCB, respectively.

On business combinations, FTL, B, BPW, HIS, GWL, and JCB confine their entire discussion to "the accounting model." CWP briefly assert [p. 68] and MML discuss at length [pp. 196-202] the abuses of the options available prior to APB Opinions 16 and 17, but they do not suggest that issues transcending "the accounting model" dominated the rhetoric of the Financial Executives Institute, the Federal Trade Commission, and the Justice Department, all of which sought mightily to influence the APB's deliberations. Even within the APB, "economic consequences" issues arose at critical junctures. All that CWP say of this epic struggle was that "much discussion" [p. 68] preceded the publication of APB Opinion No. 16.

On the highly controversial subject of foreign exchange—whose "economic consequences" have been the subject of more published research than have those of perhaps any other accounting problem area—seven of the eight "advanced" books do not even allude to any "economic consequences" issues. B [p. 546] mentions that many companies have, since the issuance of SFAS No. 8, taken actions (including hedging operations) to minimize their accounting exposure, but the economic costs alleged to have been suffered by many of these companies are not brought up, and the implications of this activity for the standard-setting process is nowhere explored.

My overall characterization of the textbook presentations is that they move from problem to problem, focusing on the narrow technical aspects and rarely planting in the reader's mind a seed of any of the larger questions. Why did this problem arise? What makes it a problem? Why was the solution developed as it was? Has it solved the problem? Has the solution created other problems? Why, indeed, were other plausible solutions rejected? How has the solution worked? These questions are seldom raised in our textbooks. When they are, the authors' responses are perfunctory and are not calculated to provoke independent and critical thought. The general course of discussion follows a standard route: here is a problem, here is the accepted solution, and here are examples which illustrate the solution. Once the student has shown, by providing solutions to numerical problems, that he/she can correctly apply the accepted solution, the next problem is asserted, *etc.*

Among the "intermediate" texts, KW is to be commended for its discussion [pp. 44-47] of the several approaches to theory formulation, including the treatment, albeit brief, of the information economics perspective. It is necessary, however, that such discussions not be confined, in large measure, to prolegomena—but that they be integrated with the later discussion.

In a section entitled "Recognition of Political Nature of Standard-Setting Process" [paras. 1.55-1.57], appearing in the first chapter of DSW, a long quotation is taken

from Horngren [1973], dealing with the pressures that were brought on the APB by the insurance industry in 1971–72 over accounting for marketable securities. But the discussion does not go so far as to suggest the “economic consequences” underlying the industry’s profound dislike for the proposed standard.

Among the “advanced” books, MML and JCB contain a chapter on the SEC, but they are limited to the formal procedures used; the substantive issues raised by the SEC over the years are not discussed. BPW [p. 9] starts promisingly with the statement, “The relatively rigid boundaries of accounting which have been widely accepted in the past need appraisal,” but this dictum is not followed up in the discussions of particular topics, at least not the ones which I examined.

In their brief introductory chapter on standards, JCB devote a paragraph to “Standards and Conflicting Interests,” in which the following provocative sentence appears: “Conflicts spring from the impact of the proposed standard on various groups whose interests are related to the financial reports” [p. 4]. But the idea is not carried forward, and it seems that the authors may not include “economic consequences” within their notion of “impact.”

I had hoped that a recent book by Meyer [1980] would devote considerably more space to “economic consequences” issues than do the “intermediate” or “advanced” books. The difference in treatment, however, is slight. In discussing the investment tax credit, Meyer aptly summarizes in a single sentence the argument for flow-through which motivated the Federal government on three separate occasions [pp. 101, 103], but the implications are not developed. In his discussions of oil and gas accounting [pp. 144–147] and business combinations [Chapter 9], “economic consequences” are totally ignored. Meyer mentions companies’ “defensive measures” against “potential gyrations” arising from SFAS No. 8 [p. 358], but the point is made fleetingly. Restructuring of troubled debt is not discussed.

What accounts for the non-discussion of “economic consequences” in “intermediate” and “advanced” accounting textbooks? Surely, their authors are not unaware and even uninformed of the phenomenon. Indeed, several of the authors—Welsch, Bedford, Wyatt, Davidson, and Weygandt—have been, or are, associated with policy-making bodies. Furthermore, as I have already suggested, the published literature is replete with references to the intrusion of “economic consequences” issues in accounting standard setting—both in North America and overseas.

It is possible that authors and publishers do not wish to tamper with a “proven product,” believing that adopters would prefer textbooks that retain the traditional approach to explaining accounting practice and policy making. Some authors, to be sure, may view “economic consequences” considerations as alien to their paradigmatic approach to accounting theory, and in this respect their judgment may be shared by the majority of accounting instructors. To admit that accounting practice may be being shaped by “political” and “economic” forces may be tantamount (in their view) to confessing that accounting has lost an important degree of professionalism and that accounting information may no longer be credible to users. Teachers might choose not to encourage these beliefs in the minds of students. Additionally, authors and teachers may judge that “the accounting model” brings more closure to debates over accounting alternatives—one can dismiss certain practices as not appropriately matching costs with revenues (given the “model”). A recognition of “economic consequences” considerations, by contrast, could well open the discussion to imponderables that would frustrate students who prefer the security of a definitive answer.

An influence which can hardly be gainsaid is the virtually complete reliance of the Uniform CPA Examination on “the accounting model.” If the Unofficial Solutions to

the Examination were to begin to refer to "economic consequences," one could expect to find corresponding changes in textbooks. But it is very doubtful indeed that the Examination would take such a course.¹ First, the problem, mentioned above, of a lesser capacity for closure in accounting discourse—*i.e.*, fewer "right" and "wrong" answers—would be a source of anguish to the examiners. Second, to the degree that leaders of the accounting profession regard "economic consequences" considerations (1) as incompatible with their own conception of how accounting theory and practice are, and should be, determined, and (2) as portending greater governmental involvement in accounting standard setting, they may exert their influence on examiners not to accord any standing in the profession's examination to such irrelevant forces. The FASB itself is an example of a leadership body which appears to have an aversion to acknowledging the role of "economic consequences" in its deliberations, even when their influence has been obvious. Although the standards in FASB Statement No. 15, dealing with the restructuring of troubled debt, were clearly affected by bankers' protestations over the "economic consequences" flowing from a required "retrospective" loss recognition for *all* restructurings, there is not a single reference in the Board's lengthy Basis for Conclusions that such considerations were weighed in the decision process. Hence, the textbook authors are not alone in their dislike for discussing "economic consequences."

Why should one mourn the absence from textbooks (and, it is likely, from most courses) of "economic consequences"? Because they constitute an indispensable element in the explanation of the forces at work in today's accounting environment. The institutional and historical dimensions of "economic consequences" help to explain why contradictory accounting practices (*e.g.*, LIFO vs. FIFO, writeoff of R and D versus capitalization and amortization of goodwill, conservative valuation of receivables generally vs. unconservative valuation of bank receivables associated with certain restructurings) are presented in the same textbook—usually without arousing students' curiosity about the existence of the contradictions. An essential part of the education of any future professional—whether in law, economics, diplomacy, or accounting—is how change actually occurs, and how it has shaped the contours of professional practice and behavior.

The entire burden probably should not be placed on textbooks, although they should not be exempted from the obligation to educate students in the kinds of change which they will encounter during their professional careers. Articles from the financial press (see, *e.g.*, the recent compilation of *Forbes'* "Numbers Game" columns in Minard and Wilson [1980]), professional and academic articles (see, *e.g.*, Horngren [1973], Savoie [1974], Armstrong [1977], and Zeff [1978]), and cases developed at Harvard, Stanford, and other institutions are available to supplement financial accounting textbooks. A recent pair of cases developed by Foster [1979] on the oil and gas industry is an example of such case materials. The "Investment Tax Credit" case in Wilson *et al.* [1979] is another.

I ask the fundamental question: shouldn't we, as accounting educators, be responsible for preparing students for the *real* world in which accounting is practiced? I am not arguing here that we forsake "the accounting model." At the very least, one must learn the "model" in order to discourse on accounting in professional circles, and, indeed, a fair number of actions which ignite accounting change *seem* to be genuinely

¹ But the Certificate in Management Accounting examination has, on at least one occasion, included a question on the "politicization" of accounting standard setting. The question, which asks candidates to give reasons for and against "politicization," appeared in the December, 1973 examination and is reproduced (as adapted) in KW, ET, and DSW.

grounded in the "model." But many are not. And our textbook authors provide precious little material even to provoke intellectually curious students to raise questions about this twilight zone in which the "model" does not dominate the debate.

I answer my "fundamental question" in the affirmative. As educators, we have a positive duty to prepare students for the turmoil in standard setting. We may dislike what is occurring. We may argue, normatively, that sound accounting practice must be rooted in a traditional "accounting model." Or we may argue, normatively, that any "model" would produce less than optimal results for economic society. Whatever our world-view of accounting, we are not excused from bringing reality into the classroom, and an explanation of accounting change which is founded only on "the accounting model" is not reality.

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