Fall 2015

Expectation Gap: The Accounting Profession, Regulators, and the Investing Public in the Aftermath of the Great Depression

Benjamin Swiszcz
Providence College

Expectation Gap: The Accounting Profession, Regulators, and the Investing Public in the Aftermath of the Great Depression

by
Benjamin Swiszcz
HIS 490 History Honors Thesis

Department of History
Providence College
Fall 2015

CONTENTS

INTRODUCTION: THE ACCOUNTING PROFESSION PRIOR TO THE GREAT DEPRESSION

Issuing their audit opinion on February 26, 1924, the public accountants at Touche, Niven and Company contended, "We further certify that, subject to the provision for federal taxes on income, the said statement, in our opinion, presents a true and correct view of the financial condition of Fred Stern and Company, Inc., as at December 31, 1923."[1] This unqualified audit opinion indicated that Fred Stern had accurately presented its financial position in its 1923 financial statements, which subsequently enabled Fred Stern to obtain a $100,000 loan from Ultramares Corporation. Because Ultramares believed that Fred Stern's financial position was stable—its financial statements showed assets of $2.5 million and net worth of $1 million—the financing entity granted Fred Stern the loan. Less than one year later, Fred Stern went bankrupt, leaving creditors to collect only cents on the dollar from Fred Stern for outstanding debt. Ultramares and other creditors later discovered that the public accountants who had issued the unqualified audit opinion on Fred Stern's financial statements had overlooked a $700,000 overstatement of assets and net worth in the company's financial statements.[2] This overstatement made it appear as if Fred Stern had more assets with which to cover its debts and reflected more favorably on the financial position of the company as a whole, increasing Fred Stern's likelihood of obtaining a loan. Ultramares filed suit against the Touche auditors, not against Fred Stern, in an attempt to recover the amount that it had loaned to Fred Stern on the grounds that the auditors

[1] James Don Edwards, "Public Accounting in the United States from 1913 to 1928," *The Business History Review* 32, no. 1 (1958): 83, http://www.jstor.org/ (accessed March 1, 2015).

[2] Michael C. Knapp, *Contemporary Auditing* (Mason, Ohio: Cengage Press, 2011), 118.

had been negligent in their conduct of the Fred Stern audit. A long legal battle ensued, and the auditors ultimately settled out of court with Ultramares.[3] The Fred Stern scandal exemplified the questionable accounting practices that became increasingly common during the Roaring Twenties. These practices would come under intense scrutiny following the stock market crash of 1929.

A major turning point in American history, the Great Depression spanned the period 1929 through 1939 and produced programs that would permanently affect the United States politically, socially, and economically. Out of the Depression arose public works programs, social welfare programs, and heavy regulations on countless industries throughout the country—including the accounting industry. While a variety of factors contributed to the Great Depression and these ensuing programs and regulations, one such major force throughout the entire Depression was the notion of uncertainty, primarily with respect to the financial environment.[4] Many individuals were uncertain about the stability of banks, the future of the stock market, and the overall safety of their money and investments. The population removed funds from banks and often sold their investments due to the lack of information about the safety of these savings and investments, thereby increasing the public's hesitancy and uncertainty about financial stability in the United States. This uncertainty among the general public, the investing population, and various other groups contributed heavily to the state of panic—both psychological and financial—that predominated in the early 1930s. Operating with limited information, individuals and businesses acted upon this general sentiment of uncertainty by making swift decisions to withdraw money

---

[3] Edwards, "Public Accounting in the United States from 1913 to 1928," 83.

[4] Peter J. Federer and David A. Zalewski, "Uncertainty as a Propagating Force in the Great Depression," *The Journal of Economic History* 54, no. 4 (1994): 825, http://www.jstor.org/ (accessed March 1, 2015).

from banks and markets, to limit losses where possible, and to openly push for restraint and regulation of the industries that seemingly caused this uncertainty.

Out of this climate of uncertainty emerged a demand for—and implementation of—considerable regulation of various business industries. The "contagion of fear" that spread throughout the general public with respect to deposits and the banking crisis in 1930 served as the foundation for this push for further regulation, not just in the banking industry, but throughout the entire financial sector.[5] Many average American citizens did not understand the inner workings of the financial system in the country, but they believed it was a key reason for the economic collapse. The more widespread that this uncertainty became, the more that citizens sought a means of rectifying both the uncertainty itself and its underlying cause through regulation. As a result of this uncertainty—and in conjunction with public perception and ultimate government intervention—a variety of industries faced regulation. Banks met with government intervention via the Emergency Banking Act, the Federal Deposit Insurance Commission, and the already existent Federal Reserve banking system. Specific industries, such as the transportation industry, confronted legislation in the early 1930s aimed at "treating the larger railroad systems in a separate manner" to stop tax evasion and make financial data more useful.[6] Financial markets and institutions continuously interacted with the newly-created Securities and Exchange Commission from the mid-1930s onward, as the Commission increased reporting requirements and set minimum accounting standards for any entity whose stock appeared on a securities exchange. The public accounting industry also faced new regulations from the Securities and Exchange Commission and the American Institute of Accountants,

---

[5] Elmus Wicker, "A Reconsideration of the Causes of the Banking Panic of 1930," *The Journal of Economic History* 40, no. 3 (1980): 571, http://www.jstor.org/ (accessed March 1, 2015).

[6] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, March 12, 1934.

including specific reporting requirements from the Commission with respect to "the form or forms in which required information [would] be set forth, the items or details to be shown in the balance sheet and earnings statement, and the methods to be followed in the preparation of accounts."[7] Just as major industries confronted new regulations, so too did accountants in the context of financial reporting requirements due to the passage of the Securities Exchange Act of 1934.

The Securities Act of 1933 required that companies issuing new securities disclose detailed financial information and register with the Federal Trade Commission. This piece of legislation served as the foundation for financial regulation during the Great Depression and began the stricter requirements for corporate financial disclosure. The Securities Exchange Act of 1934, which followed the Securities Act of 1933 and furthered regulation of the financial industries in the United States, created the Securities and Exchange Commission—the regulatory body that continues to govern financial markets and firms in modern day. The 1934 act also required that companies with existing—not just newly-issued—securities disclose detailed financial information in the form of financial statements and an annual report as well. While the Securities Exchange Act of 1934 had an immense effect upon the accounting profession by requiring greater financial disclosure and consistent reporting practices from company to company, most historians treat this piece of legislation almost exclusively in the context of the finance industry. Joel Seligman primarily addresses the Securities Act of 1933 and the Securities Exchange Act of 1934 as ways of regulating "stock exchange practices" following the stock market crash of 1929.[8] Thomas McCraw situates these pieces of legislation in the broader

[7] Andrew Barr, "Accounting Research in the Securities and Exchange Comission," *The Accounting Review* 15, no. 1 (1940): 89, http://www.jstor.org/ (accessed May 1, 2015).

[8] Joel Seligman, *The Transformation of Wall Street* (New York: Aspen Publishers, 2003), 1.

context of the New Deal but ultimately narrows his focus to how these acts created the Securities and Exchange Commission "and empowered it to change the rules of the exchanges," not the rules of accounting.[9] Eric Rauchway similarly touches upon how the Securities Exchange Act of 1934 enabled the Securities and Exchange Commission to "regulate Wall Street by preventing traders' misuse of insider information," not by mandating additional disclosure.[10] The discussion of the Securities Act of 1933 and the Securities Exchange Act of 1934 in modern historiography thus focuses heavily on financial markets and institutions, not on the impact that these acts had on professional accountancy. Despite the exclusion of this area from modern historiography, the acts of 1933 and 1934 directly affected the accounting profession through new disclosure requirements for public companies within the broader context of financial markets.

A variety of factors—including the high degree of hesitancy and uncertainty in the financial sector of the economy, the rapidly deteriorating financial situation from the stock market crash, and the ensuing banking panic—contributed to the public demand for reform of accounting practices which, in turn, prompted the government to pass regulatory legislation like the 1933 and 1934 acts. However, public perception of various highly visible components of the economic downturn, especially with respect to finance and accounting, was one of the most significant influences that led to an outcry for—and a realization of—financial regulation in the accounting industry. The general public saw a lack of transparency in financial reporting, as many corporations disclosed minimal information about their income and financial position, leaving investors uncertain about these companies' financial positions. The public also saw a lack of consistency, as different companies calculated and presented certain items—such as net

[9] Thomas K. McCraw, *Prophets of Regulation* (Cambridge: Belknap Press, 1984), 169.

[10] Eric Rauchway, *The Great Depression & the New Deal: A Very Short Introduction* (Oxford: Oxford University Press, 2008), 62.

income—in very different ways in their financial statements, thereby impairing the comparability of this financial information from one company to another. Finally, investors confronted a lack of accountant and auditor competency, as these individuals had diverse educational backgrounds and sometimes had conflicts of interest that impaired their ability to present an objective opinion on a company's financial position. Through publications in newspapers like *The Wall Street Journal* and *The New York Times*, the general public pushed for greater transparency, consistency, and competency in the accounting profession. In response to these criticisms, the federal government passed the Securities Act of 1933, the Securities Exchange Act of 1934, and various other pieces of legislation. Through the creation of the Securities and Exchange Commission—the body tasked with regulating the accounting profession in the wake of the Great Depression—the federal government had a mechanism through which it could promote and enforce change in accounting practice.

Even though the federal government had the power to regulate professional accountancy singlehandedly through the use of the Securities and Exchange Commission, the Commission adopted a policy of cooperation with the accounting profession to address the public's concerns of transparency, consistency, and competency. With general guidance and oversight from the Commission, the accounting profession implemented a variety of reforms to improve its policies and practices going forward. Through the use of publications like Accounting Research Bulletins, stricter educational requirements, and a greater emphasis on auditor independence, the accounting profession reacted directly to the public's concerns of transparency, consistency, and competency. The financial uncertainty in the American economy leading up to and during the Great Depression prompted an outcry among the investing public for reform of accounting practices. This outcry served as an impetus for the government to pass regulatory legislation that created the Securities and Exchange Commission as a way to assuage the concerns of the public. This Commission, through its policy of cooperation with—and guided self-regulation of—the accounting profession, ultimately led to the profession's concrete attempts to increase transparency, consistency, and competency within accounting practice.

UNCERTAINTY

As the United States entered into the Great Depression in late 1929, its citizens began to feel the constricting effects of uncertainty and opacity in the financial sector of the economy.[11] Uncertain of the safety of their money, many Americans withdrew their funds from banks and contributed to the Banking Panic of 1930, which only added to the immense uncertainty present at the time.[12] Likewise, as the stock market continued to decline and Americans were extremely hesitant about unstable securities, citizens continued to withdraw their funds from the market, thereby contributing to the hysteria, panic, and downward trends. Amid these developments, hesitant Americans began to criticize the entities and institutions that contributed to financial opacity and uncertainty, especially the accounting profession. Indeed, many Americans believed that the presence of insufficient, inconsistent, and irrelevant information in financial reports made it difficult to truly understand the value of companies and their corresponding securities. Coupled with contentions of auditor bias and unprofessionalism, these critics of the accounting profession began the push for reform and regulation in accountancy.[13]

---

[11] Federer and Zalewski, 825.

[12] Wicker, 571.

[13] Hossein Nouri and Danielle Lombardi, "Auditors' Independence: An Analysis of Montgomery's Auditing Textbooks in the 20th Century," *Accounting Historians Journal* 36, no. 1 (2009): 92, http://www.jstor.org/ (accessed March 1, 2015).

The field of accountancy during the Great Depression included many tasks beyond the simple preparation of tax returns. The first President of the American Accounting Association highlighted fourteen different "service categories" that summarized the duties of public accountants at the time, all of which extended far beyond return preparation. Accountants conducted audits, which involved inspecting companies' financial statements and verifying that the company fairly presented its financial information. Public accountants also assisted with the preparation of financial statements, performed some simple bookkeeping work, and offered their professional advice to companies on accounting practice.[14] Internal company accountants, in contrast, worked to generate bookkeeping records and create their companies' financial statements which public accountants then had to review and verify.[15] For both internal and public accountants, daily tasks far exceeded the preparation of individual income tax returns; rather, these tasks revolved around the preparation and subsequent verification of financial statements which companies then made available to investors and the general public. It was in the context of these latter accounting roles that the general public raised issues about transparency of information, consistency of preparatory techniques, and competency of accountants themselves.

The criticisms of the public were not unjustified. In the years leading up to the Great Depression, the accounting profession was largely self-regulating, and many of its standards were lax. For example, in order to qualify for programs run by the American Institute of Accountants to prepare students for the profession, college students did not even need to take any courses in accounting. Rather, the Institute recruited on the basis of general intelligence, clean

---

[14] Alan Mayer-Sommer, "Public Accounting in 1929," *The Accounting Historians Journal* 7, no. 2 (1980): 29, http://www.jstor.org/ (accessed March 1, 2015).

[15] James Don Edwards, "Public Accounting in the United States from 1928 to 1951," *The Business History Review* 30, no. 4 (1956): 446, http://www.jstor.org/ (accessed March 1, 2015).

appearance, and personal ambition.[16] This was still the practice in 1929 at the time of the stock market crash.

Paralleling this inconsistency in qualifications for recruiting was a similar inconsistency in testing and examinations. While thirty-seven of the forty-eight states in 1929 used a standardized set of questions for certified public accountant examinations, the other eleven states—which notably included New York, the state which provided over twenty percent of certifications—devised and administered their own examinations.[17] Because of these differences from state to state, historians highlight the "wide variation in the competence of auditors." Some states' exams were "adequate," while others were "not so adequate" due to the differing levels of difficulty.[18] The certified public accountant examinations in each state served to reject individuals unqualified to practice in public accounting, but the variances from state to state produced a wide range of accountant competency in practice. Certified public accountants in the period from 1929 through 1935, then, did not possess uniform and comparable skills, backgrounds, or qualifications. As a consequence, even with guiding literature like the 1929 Federal Reserve Board booklet *Verification of Financial Statements* available to them, accountants understood, interpreted, and practiced in markedly different fashions.[19]

Different firms and accountants quite frequently employed inconsistent reporting methods that jeopardized the comparability and comprehensibility of financial information. Because of their different backgrounds, accountants and their firms all interacted with "lax definitions, confused and nonuniform usage, and [the] absence of generally accepted definitions

---

[16] Mayer-Sommer, 24.

[17] Mayer-Sommer, 25.

[18] Jeremy Wiesen, *The Securities Acts and Independent Auditors: What Did Congress Intend?* (New York: AICPA Press, 1978), 38.

[19] Edwards, "Public Accounting in the United States from 1928 to 1951," 445.

of words in financial statements and certificates."[20] Outside the realm of large public companies, many smaller companies only issued uncertified statements which a public accounting firm had not audited or signed off on. Staff accountants within each company who had even less guidance to follow and fewer standards to which they needed to conform had the task of preparing these statements. Inconsistency resulted, and after the "tremendous losses suffered" from the 1929 stock market crash, "it became clear that businessmen, bankers, and accountants had not given proper emphasis to the auditing standards set forth" by the American Institute of Accountants or the Federal Reserve Board. In essence, the stock market crash of 1929 led many individuals throughout the business world and general public alike to realize that "proper accounting methods… might have prevented some of the financial losses of the day."[21] While inconsistency in reporting methodology was an issue for many years leading up to the crash, people did not identify financial reporting as a major problem until 1929, when the stock market collapse indicated the need for useful financial information to make adequate investment decisions.

Finally, the accounting profession in 1929 suffered from non-transparent information that rendered financial statements and other documents nearly useless. Financial statements were in many cases so complex that it required extreme expertise to be able to comprehend them. Even though accountants did not necessarily need to have a strong background in accountancy to be able to join the profession, they nonetheless needed to familiarize themselves with the jargon and terminology of financial reporting to be able to interpret the meaning of companies' financial statements. Most members of the general public lacked even this knowledge of terminology that accountants—competent or not—possessed. Public accounting firms' certifications were sometimes "long" and other times "short." In some instances, they were "qualified," while in

[20] Mayer-Sommer, 30.

[21] Edwards, "Public Accounting in the United States from 1928 to 1951," 446.

others they were "unqualified."[22] Some certifications referred only to certain company statements and documents, while others referred to all available statements. Writing during the Great Depression, Professor David Himmelblau of Northwestern University contended that an ideal certification was "one that convey[ed] precisely the right shade of meaning to anyone who studie[d] carefully every word, and at the same time create[d] the correct general impression in the mind of anyone who [read] it casually." Certifications thus could communicate different information to different readers through the use of vague language. Rather than simply using concrete, straightforward language, many accountants used unclear wording that did not necessarily have one meaning or interpretation for all readers. Transparency was very poor as a result. There was an "absence of generally accepted definitions of words in financial statements and certificates." Words such as "qualified" and "unqualified" lacked clear definitions, and terms like "net income" and "profits" did not have standard meanings or computations associated with them. The information in financial statements was hazy at best, and to the average reader or investor, this information often lacked interpretive value because the terms contained therein were so vague. As such, bankers and other lenders frequently made decisions solely on the strength of a public accounting firm's name, not on the basis of the content of the firm's certification. The opacity of public accounting firms' writings and opinions was incredibly detrimental to decision-making ability for loans, investing, and other similar activities.[23]

---

[22] Historically, auditors' reports took a variety of forms. While short-form audit reports dealt primarily with the scope of the audit work conducted and the findings of the audit, long-form audit reports were more detailed and comprehensive. Qualified and unqualified opinions differed in the extent to which an auditor could offer an opinion on a particular set of financial statements. An unqualified opinion generally conveyed an auditor's belief that the financial statements of a company were free from material errors or misstatements that could be detrimental to investors relying on those financial statements. Qualified opinions, on the other hand, similarly stated that a company's financial statements were free from material error *except for* a certain area or scope limitation that forced the auditor to limit, or qualify, that opinion.

[23] Mayer-Sommer, 30.

Overall, the accounting profession faced a period of inconsistency and uncertainty between 1929 and 1935. In addition to these general trends and changes, the profession encountered difficulty with several much more technical accounting issues as well. Two such issues—both of which attracted heavy attention and criticism from the general public in the context of consistency—were the calculation of a company's net income and the fair presentation of a company's financial position on its balance sheet. While net income and fair presentation were popular jargon in the business community in the early 1930s, their exact definitions were not always clear. Net income, now defined as the amount by which a company's revenues exceed its expenses for a given period, presented challenges for the accounting profession since the interpretation and calculation of revenues and expenses varied from one public accounting firm to another. Some firms included dividends, or distributions of profits to a company's owners, in their earnings calculations while other firms did not.[24] Other firms subtracted interest expense, or the cost of borrowing money, in their income calculations while still other "equally well-respected" firms did not.[25] The concept of net income meant something different to nearly every accountant, and this became a major point of contention with the general public because of the confusion and uncertainty that it caused, particularly among bankers and investors. Bankers typically gave loans to companies which had substantial income in the past since these companies likely would be able to pay back the loans by generating similar income in the future. Investors tended to purchase the securities of companies with high profitability since these companies likely would not go out of business and would produce a high return on investment. By manipulating net income, accountants could mislead bankers and

---

[24] "Bond & Share Income Larger," *New York Times*, June 13, 1929.

[25] Mayer-Sommer, 30.

investors, as well as induce them to make poor lending and investing decisions based on misrepresented or inaccurate income figures.

The second of the major technical issues which the accounting profession faced was the presentation of certain items on a company's balance sheet. In colloquial terminology, a balance sheet is simply a statement of the various assets that a company owns, the obligations that it has to other entities, and the value—referred to as net worth—of the company as of a particular date. This financial statement shows what a company has, what it owes, and what it is worth. Though a seemingly simple statement that has a great deal of informational value—especially for bankers and investors making lending and investing decisions—companies' balance sheets also posed a distinct set of problems for those relying on the information contained therein. For example, companies and accounting firms frequently struggled with classifying dividends on a balance sheet, fairly presenting inventory, and addressing the issue of overvalued assets. The computation and reporting of certain values on the balance sheet thus was a major issue for the accounting profession in the early years of the Great Depression.[26]

Complicated, technical accounting concepts thus played a very important role in the Great Depression, as they served as some of the major points of contention in the responses of the general public. In a period of extreme uncertainty, these technical issues of net income and fair presentation only generated further hesitancy among the general public. The public already was fearful of the safety of its money in banks and the stock market, and these technical accounting issues that greatly reduced the utility and comprehensibility of financial information simply added to this fear. Because investors, bankers, and the general public could not trust the financial data that companies presented, these individuals became even more uncertain as to how to invest their money in financial markets plagued by opaque, inconsistent accounting

[26] Charles Shipman, "Inquiring Investor," *New York Times*, September 23, 1933.

information. By adding to the uncertainty, then, these technical accounting issues furthered the environment of uncertainty, added to the financial and psychological elements of panic, and worsened overarching accounting issues like transparency and consistency during the Great Depression.

Out of this environment with both conceptual shortcomings and technical problems emerged a set of strong responses from the general public about the accounting profession. These responses, which centered on the clamor for additional regulation and reform of the issues within the profession, addressed three major areas—transparency, consistency, and competency. These three areas of focus existed not only in the responses of the general public, but also in the government's crafting of regulatory legislation and in the self-regulatory reactions of the accounting profession. The various shortcomings in accounting theory and practice during the 1920s directly led to a public outcry that prompted government regulatory efforts. This established a new precedent where the laissez-faire nature of the accounting profession that predominated in the 1920s succumbed to a new era in which the federal government had the power to regulate and guide the accounting profession. Although the government allowed the profession to self-regulate even after the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934, ultimate authority over professional accountancy remained with the Securities and Exchange Commission throughout the following decades and into modern day.

THE PUBLIC CRIES OUT: CRITICIZING SHORTCOMINGS IN ACCOUNTANCY AFTER THE CRASH

In the wake of the stock market crash of 1929, the investing public sought greater reform in financial markets and in the financial reporting that played such an integral role in these markets. Due to the environment of uncertainty following the stock market crash of 1929, investors sought a higher standard for financial reporting that would give them more comfort when investing. Given the previous history of scandals—as in the case of Fred Stern's grossly inaccurate financial statements—and the presence of massive financial instability after the crash, the investing public sought a way to increase the quality of financial information available to them when making investing decisions. While accountants understood that financial reporting involved judgment calls about how to present certain items, the investing public regarded the information in these financial statements much more objectively. In his testimony before the Senate Banking and Currency Committee in 1933, Colonel Arthur Carter contended that investors were "too prone to regard balance sheets and income accounts as positive and indisputable statements of fact."[27] Even though seasoned accountants like Carter—president of the New York State Society of Certified Public Accountants—knew this understanding was inaccurate, the investing public firmly believed that companies' financial statements were wholly accurate documents upon which investors could rely without any doubt.

Operating under the notion of financial statements were—or should have been—indisputably factual representations of financial position, investors clamored for regulation of the

[27] Wiesen, 23.

accounting profession in ways that would improve the quality of financial reporting. In doing so, the investing public focused their attention on three main areas—transparency in financial reporting, consistency in the manner of such reporting from one company to the next, and competency among the practitioners of accountancy who were responsible for preparing and auditing financial disclosures. These investors believed that, through federal government regulation of the accounting profession, the quality of financial statements would increase substantially and give investors something to rely upon when making investing decisions in the environment of financial uncertainty after 1929.

TRANSPARENCY

Commentary on the lack of transparency in the accounting profession largely targeted the lack of appropriate or applicable standards for computing various items like net income and balance sheet amounts. In "Letters to the Editor" in a 1932 issue of the *New York Times*, one reader vehemently argued that the information published by corporations and signed off on by public accounting firms was "utterly inadequate both as regards completeness or frequency" since accountants often provided a great deal of information but chose to "omit essential facts and frank explanations" relating to the calculations for certain values or numbers.[28] Essentially, a number for net income or for a particular asset simply appeared on a company's financial statements with no explanation or elucidation as to which methods the accountants used. Without any such explanation, the information was very opaque since the public could not understand certain values and therefore struggled to compare these numbers to those of other firms.

Another important component of the general public's push for further transparency in the accounting profession was the need for strict conformance to accepted accounting principles. A

[28] "Letters to the Editor," *New York Times*, November 4, 1932.

1934 newspaper article in the *New York Times*, aptly titled "Authentic Information on Corporate Affairs Ought to Be Included in Securities Legislation," stressed the necessity of genuine accounting information based on appropriate practices. The article's author contended that corporations must file their financial statements "in content and form according to established practices in the trade and the accepted principles of accounting" so that investors and the public would have access to truly transparent, useful information. While uniform principles standards would not remove all subjectivity from financial reporting, they would nonetheless help to remove the wide variation in financial reporting practices. This proposed regulation, coupled with the need for auditor independence, "could do much more to protect the public from receiving misleading and inadequate information" than many other changes could.[29] By simply following accepted accounting methods and principles—especially with respect to the often confusing concepts of income calculation and balance sheet presentation—companies could easily enhance the transparency of their financial statements and avoid misleading the average citizen who sought clarity in the financial information before him or her.

Equally significant in the public's quest for greater transparency was the desire of the average citizen for companies to make more financial information available to their stockholders. In the years of uncertainty following the stock market crash in 1929, many average investors sought "full publicity of all pertinent facts" relating to a company's financial situation.[30] Other Americans hoped that, in annual reports, companies would "disclose the identity of all persons 'owning directly or indirectly substantial interests'" in that particular company so that investors

---

[29] A.C. Littleton, "Authentic Information on Corporation Affairs Ought to Be Included in Securities Legislation," *New York Times*, February 25, 1934.

[30] William H. Geimes, "Securities Act Fight Looming," *Wall Street Journal*, August 7, 1933.

would be aware of related-party transactions, causing transparency to increase.[31] Still other Americans touched upon some of the major accounting issues directly and demanded "full disclosure of what [was] done with a corporation's assets and the accounting thereof" in the hopes of gaining fuller information that would be more beneficial to the public.[32] This comment in particular focused on the problem of balance sheet presentation of items such as dividends, earnings, and certain assets. The public wanted to understand what truly occurred in a particular year for the companies in which they invested, as well as what that company's assets and obligations were really worth. These issues related heavily to the desire for greater transparency of information and thus greater understanding among the public which grew tired of uncertainty in the financial environment.

Overall, the outcry for greater transparency—especially with respect to the calculation and reporting of certain items—grew entirely out of the need to avoid misleading information. In an era marked by extreme uncertainty in the market, the public grew to detest information that was "false or misleading in respect of any matter sufficiently important to influence the judgment of the average investor."[33] The accounting profession, they believed, was at least partially responsible for the confusion and opacity that predominated in the investing world at the time of the stock market crash. As a result, by pushing for regulation that enhanced clarity, transparency, and fair reporting of information, the general public believed that it could enable the passage of legislation that would help the average investor by quelling the uncertainty that ran rampant during the Great Depression.

---

[31] "'Innocuous'? 'Evasive'?" *New York Times*, October 26, 1932.

[32] "As to Stock Dividends," *New York Times*, December 10, 1937.

[33] "Highlights of the Stock Exchanges Bill," *New York Times*, February 10, 1934.

CONSISTENCY

The second major focus of the general public in its reactions and responses to the accounting profession during the Great Depression was consistency. Citizens recognized the need for uniform accounting practices across different public accounting firms and across different industries, as the varying practices and methods decreased the comparability of financial information from one entity to the next. The railroad industry—one of the largest in the United States during the 1930s—experienced this inconsistency of information between companies, as different railroads used varying methods to report cash disbursements and to calculate net income, thereby limiting the comparability of these companies' financial information. Consequently, the public began to suggest that "standardized reporting methods be adopted by the various railroads" so that investors could compare different railroads' financial statements effectively.[34] Unless methods and practices were consistent from one entity to the next, companies' financial statements were incomparable, thereby requiring investors to view each company effectively in isolation without a guideline or reference point. Even though the average American lacked technical accounting knowledge, the public began to examine the systems used by different companies and increasingly sought a uniform system of accounting for federal, state, and financial reporting purposes.[35] Unless information and practice was consistent from one entity to the next, the uncertainty that the public loathed would not disappear since there would be no definitive standard or baseline upon which investors could make judgments.

As a part of this desire for greater consistency in accountancy, the public asked for clear disclosure of accounting methods in companies' financial statements so that individuals would

---

[34] "Uniform Accounting Urged for Railroads," *New York Times*, 1937.

[35] "To Study Accounting Systems," *Wall Street Journal*, September 29, 1931.

be better able to interpret and compare information. In one *New York Times* article from 1934, the author echoed the sentiment of the general public and demanded that legislators "[l]et every word stand that call[ed] for *disclosure* concerning corporation properties and activities and the accounting by which these [were] recorded."[36] Indeed, through commentary and articles such as this, many average Americans aggressively petitioned the government to regulate the accounting profession in a way that would require greater disclosure of information and would enhance the comparability of companies' financial statements. By merely disclosing—not changing—the accounting method they used, companies likely would report various different accounting methods. Though inherently problematic because of the lack of one specific method for all firms, this disclosure would at least give the general public an idea of which information was comparable to that of other firms and which information was not. Without first understanding how the methods employed by various companies differed, investors could not seek an adequate remedy for this inconsistency. This type of regulation that the public sought would conveniently also serve to increase transparency, as disclosure of method would also allow the American investor to better comprehend what a company's income, asset, and earnings figures actually represented.[37]

Balance sheet presentation was an especially pertinent issue within the public's demand for greater regulation that would enhance consistency. Indeed, one major area in which the American public sought greater consistency was the presentation of dividends. While the average investor did not necessarily understand the exact technicalities of stock dividends, stock split-ups, and other complex topics, he or she nonetheless desired that all companies report these

---

[36] "Public Interest Requires Further Changes in Bill," *New York Times*, March 24, 1934.

[37] "As to Stock Dividends," *New York Times*.

items in the same way and disclose the accounting method used.[38] Some members of the public explicitly stated that, through regulation, accounting "should be adapted" to "show at any given time the exact amount of realized undistributed earnings" after the payment of dividends.[39] If the federal government regulated the profession effectively, they argued, a consistent method of presenting dividends on the balance sheet or a separate statement would enhance the quality of information available to the public and ameliorate some of the uncertainty that predominated during the 1920s. During its decades of self-regulation, the accounting profession had not required any real consistency in terms of both dividends and general reporting practice, so the American public sought legislation and federal government regulation that would assist in the attainment of this end.

The public also sought consistency in the presentation of inventory and other assets on companies' balance sheets. Leading up to the Great Depression, there was no particular consistency—and in many cases, accuracy—to the way that accountants reported inventory on company balance sheets. Auditors frequently accepted whatever numbers a company's staff accountants provided, as in the McKesson & Robbins scandal of 1938. In this fraud case, the accounts at McKesson & Robbins inflated the company's inventory and earnings numbers on its financial statements, which came to light when the Securities and Exchange Commission conducted an investigation in 1938. The company's audit firm—Price, Waterhouse and Company—did not verify that McKesson's inventory actually existed in conducting its audit of the company's financial statements, so these auditors "failed to discover the gross overstatement of assets and of earnings" because they did not perform any "actual observation of

---

[38] "As to Stock Dividends, *New York Times*.

[39] "Stock Dividend Rules Outlined, *New York Times*, May 1, 1930.

inventories."[40] The inventory balance that appeared on McKesson's financial statements was drastically higher than it should have been, as the company's accountants inflated the numbers to make the company appear more profitable. While some companies properly recorded inventories at cost, others adjusted inflated inventory prices so as to appear more profitable—as in the case of the McKesson & Robbins. Even the most prestigious public accounting firms like Price, Waterhouse and Company believed that the "verification of physical inventories was not within the special competence of auditors," so they accepted the numbers that the client's accountants provided, and inconsistency proliferated as a result.[41]

With no real checks on the way that these inventory values appeared on financial statements and with no consistent method for accurate reporting, accountants frequently inflated, overstated, and occasionally made up inventory figures.[42] As a result, the public demanded "sufficient checks on quantities of inventories" so that accountants would accurately report these quantities in financial statements. This also would effectively force accountants to use one consistent method of inventory reporting based on verifiable quantity and cost, not on unchecked and inaccurate figures.[43] Unless factuality and accuracy were consistently present, inventory figures possessed little real value. Investors and the public could evaluate a company's net worth inaccurately and invest in an unsound company destined for failure. This would increase public uncertainty and hesitancy about investing their money. As long as investors remained uncertain about a company's true financial position, they would be hesitant to invest in that company, thereby worsening the environment of uncertainty and the elements of financial panic; investors

---

[40] Edwards, "Public Accounting in the United States from 1928 to 1951," 450.

[41] Mayer-Sommer, 27.

[42] Edwards, "Public Accounting in the United States from 1928 to 1951," 452.

[43] "Costs Would Be Factor Facing Stockholders in Accounting Change," *New York Times*, January 7, 1939.

would keep their money idle and out of the market. By regulating the profession, then, the government could enhance consistency, comparability, and verifiability in the financial world.

In order to remedy overstated asset values, the public desired regulation that would require assets to be written down to actual value, which was a consistent and verifiable standard. This concept of writing an asset down to actual value entailed decreasing the value assigned to this asset on a company's financial statements and showing a loss on their income statement due to a decline in value. This decline in value typically related to asset obsolescence, changes in market prices, and changes in the amount of consideration that companies could expect to realize if they were to sell this asset. Many companies avoided this practice since they would then have to report lower assets, lower net worth, and lower income due to the loss they had to recognize. Because companies did actively adopt this practice on their own, the public sought regulation that would force accountants to write assets down to actual value, where appropriate. Indeed, the public demanded "revamped accounting methods" that would require assets to be written down from the inflated values on paper that "were insufficient to carry the corporations through a depression slump" when the public lost confidence.[44] As long as assets remained overstated, there would be no consistent standard of reporting, and investor confusion and uncertainty would remain. With respect to these various balance sheet items, then, the public pressed the government to intervene through regulatory efforts that would require consistency, enhance the value of financial reporting, and thereby increase the comparability of financial information from one company to the next, all in an effort to cut down on public uncertainty. Without using similar methods from one firm to the next, and without clearly explaining these methods so that investors could intelligently compare one company to another on the basis of its financial

[44] "Bernard Kilgore, "Reading the News of the Day," *New York Times*, March 30, 1933.

statements, the financial information in the hands of investors would remain largely useless, thus necessitating proper regulation.

COMPETENCY

The third, and final, major area in which the general public sought regulation of the accounting industry was professional competency. After the stock market crash of 1929, the public began to realize that—among other factors—the speculative judgment of professionals in the accounting and finance industries contributed heavily to the crash itself and to the ensuing uncertainty and panic.[45] As a result, the public's desire and need for capable certified public accountants grew considerably stronger in the years between 1929 and 1935. In 1929, most accountants possessed only a high school education and remained largely unregulated by the government due to the presence of professional societies like the American Institute of Accountants that typically handled disciplinary matters.[46] In addition, conflicts of interest frequently posed problems for accountants and auditors. If an auditor had connections to high-level management in a company, owned a substantial part of a company, or had some other self-serving interest in seeing the company do well, he or she likely would not give an objective opinion on that company's financial statements. Because they had to certify the fair presentation of a company's information, auditors needed to remain unbiased by their personal interests and offer their objective judgment. However, the profession did not explicitly address the issue until 1934—the first year in which the term "independence" appeared in the revised edition of the oldest and most heavily used auditing textbook in the United States.[47] The overall lack of

[45] "It is not Regulation but Handcuffs for Industry," *Wall Street Journal*, February 16, 1934.

[46] Mayer-Sommer, 37.

regulation, in conjunction with the independence issues in the profession, prompted the general public to pursue regulation that would enhance auditor capability and competency. Many Americans pushed for proficient public accountants to perform "a complete, *independent* report" on companies' books that reflected proper professional judgment.[48] Without appropriate knowledge, judgment, and freedom from conflicts of interest, auditors and accountants did not possess the competency necessary to adequately perform their duties. The public pushed for regulation that would establish sufficient standards of conduct and training for the accounting profession in an effort to improve financial reporting in the wake of the 1929 market crash.

Another important element of the public's pursuit of accountant competency was the need for auditors to express their informed opinions on a company's financial information after following established procedure. Prior to the regulatory reforms of the 1930s, public accountants explicitly certified the contents of a company's financial statements and thereby affirmed the validity of the information contained therein.[49] These certifying statements engendered a false sense of confidence in the financial data presented to the investing public because individuals typically trusted auditors' supposed expertise and believed the certified financial information to be wholly accurate, though this often was not the case. This financial information came from the accountants at the client company, not from the auditors, so the auditors occasionally certified information that was inaccurate in cases of client fraud and misrepresentation. This contributed to uninformed decisions based solely on the name of the public accounting firm certifying this data, not on the accuracy or quality of the financial data itself.[50] As a result, the public requested

---

[47] Nouri and Lombardi, 82.

[48] "A Little Auditing, Please," *New York Times*, 1938.

[49] "'Certified Accountancy,'" *New York Times*, August 6, 1931.

[50] Mayer-Sommer, 30.

reform and regulation that would require auditors to give unqualified opinions on a company's financial statements, not make certifications of fact that could mislead the public.[51] Outwardly certifying the validity of a company's financial statements communicated to the investor that the financial data contained therein was wholly accurate and properly presented, whereas an unqualified opinion indicated that the auditor personally believed—to the best of his or her ability—that a company's financial information was fairly presented. The public recognized that opining was all that was "humanly possible for [auditors] to do," not expressly validating a company's financial information.[52] While these comments undoubtedly related to issues of language and structure, they also directly related to the need for competency among accountants and auditors, as members of the profession needed to make adequate judgments and express these judgments appropriately so as to provide useful information and not deceive the public. A competent auditor would be able to opine instead of certify, to comment instead of validate, and to inform instead of confirm. Unless prompted by regulation and an outcry from the public, however, the accounting profession had no compelling reason to change its longstanding practice of certification.

A final element of the public's reactions to accountants' professional competency—or lack thereof—was the need for auditors to maintain a certain standard of good judgment when reviewing a company's financial statements. Indeed, the American public insisted that auditors maintain a "standard of reasonableness" comparable to that "required of a person occupying a fiduciary relationship."[53] An auditor needed to exercise good judgment and maintain a high level

---

[51] "More Complete Audits Urged: Accountants Institute Asks Exchange Committees Opinion on Submitted Form," *New York Times*, December 25, 1933.

[52] "Certified Accountancy, *New York Times*.

[53] "Accountants Win in Securities Rule," *New York Times*, April 8, 1934.

of responsibility so as not to affirm inaccurate information or mislead the investing public. The public encouraged movement toward actual verification of inventories and appropriate calculation of a company's income as opposed to taking a manager's word at face value without giving it due diligence, as had been the case for decades prior to the Depression.[54] The public wanted auditors to practice good judgment when reviewing financial information, to develop an appropriate standard of understanding, and to maintain a reasonable level of independence on any audit they conducted.[55] In doing so, the accounting profession would be better able to avoid misleading the public and to curb the uncertainty present in the business world, all by attaining and maintaining an appropriate level of professional competency. While this was part of the larger context of professionalization of accountancy—similar to the professionalization of other industries like medicine and law—it nonetheless was inextricably bound up in the investing public's desire for greater competency among accountants.

MOVEMENT TOWARD REGULATION

These various concerns about transparency, consistency, and competency all related to the major issues in the accounting profession between 1929 and 1935. The varying calculations of net income without any explanation as to the method used made much of the financial information opaque, inconsistent from one company to the next, and a reflection of the different levels of understanding among various auditing firms. Likewise, the varying and often overstated presentations of items like dividends and assets on companies' balance sheets also made it difficult for investors to understand a company's true financial position, limited the comparability of one company's performance to another, and illustrated the poor judgment or

---

[54] Mayer-Sommer, 27.

[55] "Exchange Rulings," *New York Times*, April 12, 1933.

performance of some auditors who neglected to verify suspicious financial information. One *New York Times* writer acknowledged in 1933 that "corporation accounting at its best [was] much less of an exact science than most people seem[ed] to think" due to its inherently estimate-driven nature. However, unless these various estimates were "conscientiously made and carefully checked by experts" like auditors, the financial statements of any company "in most cases simply [would] not mean anything."[56] The various shortcomings of the accounting profession—particularly with respect to the technical issues of income and balance sheet presentation—thus compromised the utility of companies' financial statements and caused the public to demand greater regulation by the early 1930s.

These reactions were also largely reflective of the public's attempt to mitigate the uncertainty that was so prominent after 1929. The inconsistency, incompetence, and lack of transparency that resulted from the actions of the accounting profession all prevented investors—and the general public—from making informed decisions about how to invest and use their money. When financial statements and other data possessed varying levels of authenticity, verifiability, and transparency, their utility decreased substantially and contributed to the uncertainty among investors in the United States. Without adequate accounting information upon which they could rely, investors frequently made decisions based on speculation rather than fact, only adding to the uncertainty present in the country at the time.[57] As a result of this uncertainty, the public became increasingly cautious about participating in the stock market, investing, and interpreting accounting information, all of which served to increase hesitancy and further the sentiment of public panic that resulted from the market crash of 1929.[58] This increased the desire

---

[56] Bernard Kilgore, "Reading the News of the Day," *New York Times*, February 3, 1933.

[57] "It is not Regulation but Handcuffs for Industry," *Wall Street Journal*.

of the general public to avoid uncertainty and only made the uproar for regulation that much stronger. By the early 1930s, the American public viewed regulation as a way to "compel those who issue securities to provide along with them all the information bearing upon their origin which is essential" to making proper estimates of value and future performance.[59] While this viewpoint did not solely apply to accounting, it nonetheless related to the necessity of reliable financial information—a need in which the accounting profession was inextricably wrapped up. These various public reactions, then, directly related to both technical accounting issues and the climate of uncertainty that made regulation and reform both necessary and desirable for the future of the American financial industry.

The eventual success of the general public in provoking government legislation was not simply a result of the merits of the public's criticisms, however. Rather, the success of these public responses in leading to greater regulation by 1934 was the result of a multiplicity of factors, the two most important of which were the highly publicized nature of these responses and their applicability to the uncertainty in the United States at the time. First, many of the reactions of the general public appeared in national newspapers such as the *New York Times* and the *Wall Street Journal*, major newspapers with a heavy readership and national audience in the period from 1929 through 1935.[60] Because of the national nature of these newspapers, they attracted the attention of legislative and regulatory entities throughout the United States and especially in New York and Washington, D.C. One 1932 *New York Times* article noted that public opinion prompted membership organizations to recommend "stricter regulation" policies

---

[58] "Street Gossip: Corporation Loans," *New York Times*, February 27, 1929.

[59] "Wholesome in Intention," *New York Times*, December 8, 1932.

[60] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, September 23, 1932.

to the United States Chamber of Commerce.[61] Another article in the same newspaper indicated that the governor of New York recommended further regulation of financial institutions to the New York legislature, likely as a result of public demand.[62] Perhaps most importantly, some other articles incorporated the responses of—and therefore increased the awareness of—members of the United States Senate, as in the case of a *New York Times* article that included commentary from Senator Robert Buckley of Ohio on the issue of prosperity and regulation. This helped to nationalize the issue of accounting regulation and boosted its recognition throughout the country because of the high profile individuals who addressed the topic.[63] While some responses of the general public undoubtedly appeared in smaller local newspapers, the ones that appeared in newspapers like the *New York Times* and *Wall Street Journal* reached a large audience and brought attention to the various issues in the accounting profession on a national scale, thereby increasing the awareness of legislators and prompting reform measures. Although the profession's responses—primarily in the form of Accounting Research Bulletins and other publications—were not as visible in the public sphere and had a limited popular readership, the critiques of the public nonetheless made the controversy over professional accountancy highly visible.

This heavily-publicized nature of the various critiques of the accounting industry—along with suggested methods of regulation—had a powerful effect even before the federal government passed regulatory legislation like the Securities Exchange Act of 1934. Members of academic institutions discussed the issue more heavily, such as when—in a 1932 address to the National

---

[61] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, October 4, 1932.

[62] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, March 23, 1931.

[63] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, May 20, 1932.

Association of Mutual Savings Banks—Professor W. Z. Ripley of Harvard University made "an attack on the method of accounting used" by public utility companies in response to public opinion and the potential for "a rush of popular investment" in the future.[64] Bodies like the State Bureau of Securities in New York began to make regulatory suggestions and recommendations as early as 1930, when it suggested that the New York Stock Exchange "work out [an] independent auditing system tending to give public protection" against potential failures.[65] Public commentary also prompted a decision by the Public Service Commission in 1932 stating that the New York Telephone Company could not deduct charity contributions from income due to the necessity of greater consistency, as highlighted in the critiques of the general public.[66] Thus, the various reactions of the general public and the demand for "complete and correct public corporation accounting" had some modest success prior to heavy federal regulation in 1933 and 1934.[67] In each of these cases, the various public critiques of the industry prompted responses at the state level, as various legislature and other state organizations employed many of the measures that the public highlighted, such as consistency of income calculation and proper auditing procedure. These state-level responses lent credibility to the public's calls for national reform.

The public demands for transparency, consistency, and competency would be essential to the successful passage of accounting reforms. Because of the uncertainty in the American business world between 1929 and 1935, the desire and push for regulation in the wake of the

[64] "Newspaper Specials: Condensed Exclusive Items of Financial Interest from Metropolitan Newspapers," *New York Times*, May 21, 1932.

[65] "Newspaper Specials: Condensed Exclusive Items of Financial Interest from Metropolitan Newspapers," *New York Times*, July 14, 1930.

[66] "Newspaper Specials: Condensed Items of Financial Interest from American Newspapers," *New York Times*, April 1, 1932.

[67] "Nemesis in Office," *New York Times*, October 22, 1932.

stock market crash only increased. Many investors—professional and amateur alike—who lost money during the market crash of 1929 sought to avoid another crash and thus wanted to eliminate uncertainty via regulation and standardization of accounting practice. While some individuals who worked in the accounting profession were more resistant to change, the large majority of people sought regulation and standardization. This would, in theory, give investors "adequate reason to have confidence" in the market and the business world once again.[68] Out of this environment came the government regulatory efforts of the 1930s.

---

[68] "Inquiring Investor: Intelligent Inquiry is the Public's Safeguard," *New York Times*, August 21, 1930.

THE GOVERNMENT REACTS: FINANCIAL REGULATION OF THE ACCOUNTING PROFESSION

In response to the variety of public reactions to the accounting profession, the federal government introduced legislation with the aim of regulating accountancy. These pieces of legislation were direct responses to the outcry of the general public about consistency, competency, and transparency in the years from 1929 through 1935. Legislation like the Securities Act of 1933 and the Securities Exchange Act of 1934, as applied to the business environment through the vehicle of the Securities and Exchange Commission, contained numerous provisions that directly addressed the public's concerns. These pieces of legislation ensured transparency by requiring a registration statement containing certified financial statements for companies issuing new securities, brought consistency by giving the Commission the power to determine the form and appearance of financial disclosures, and guaranteed competency by imposing strict liability standards for auditors relating to certified financial statements. These provisions would give the government the potential to regulate the accounting profession heavily, even though the Securities and Exchange Commission adopted an overall policy of "self-regulation" of the accounting profession with some general oversight.[69]

In its first major attempt to regulate accounting and corporate finance following the stock market crash of 1929, Congress passed the Securities Act of 1933. This act was part of President Franklin Roosevelt's New Deal programs aimed at addressing the financial environment and improving the economy overall. Congress also passed this act during the First Hundred Days of

---

[69] McCraw, 187.

Roosevelt's presidency, thereby making it a central part of Roosevelt's priority reform efforts during the Depression.[70] Addressing the public's concerns about transparency, the 1933 act sought "to provide full and fair disclosure" of financial information relating to newly-issued securities so that investors could have a greater level of confidence in the securities in which they were investing.[71] In addition, this act empowered the Federal Trade Commission—the commission that had the responsibility for financial regulation prior to the creation of the Securities and Exchange Commission in 1934—to collect additional financial information.

The Securities Exchange Act of 1934 expanded the provisions of the Securities Act of 1933 and broadened the reach of government regulation. While the 1933 act applied only to companies issuing new securities, the Securities Exchange Act of 1934 targeted corporations with existing securities.[72] Investors would have higher-quality financial information upon which they could rely with reasonable assurance, given the fact that such information underwent an audit from an independent public accountant. In a spirit similar to that of the Securities Act of 1933, the Securities Exchange Act of 1934 used the phrase "in the public interest and for the protection of investors" numerous times in an effort to demonstrate the government's responsiveness to the outcry of the general public for greater transparency in financial reporting.[73]

In the interest of increasing consistency in the realm of financial reporting, the Securities Exchange Act created a new commission—the Securities and Exchange Commission—that would be responsible for the enforcement of both the 1933 and 1934 acts instead of the Federal

---

[70] Rauchway, 62.

[71] James Don Edwards, *History of Public Accounting in the United States* (East Lansing: Michigan State University Press, 1960): 155.

[72] McCraw, 169.

[73] McCraw, 170.

Trade Commission. The newly-created Securities and Exchange Commission could focus more heavily on specific regulations for accountancy and corporate finance than could the Federal Trade Commission which had broader consumer protection responsibilities beyond the realm of accounting and finance.[74] In addition, the Securities and Exchange Commission had the authority to establish "the form or forms in which required information [would] be set forth" for the investing public to access.[75] It also had the ability to establish accounting standards relating to the computation and presentation of certain items in financial statements, thereby ending the profession's long history of freedom from government influence but also improving consistency in accounting principle and practice as a result. In practice, the Commission cooperated with the profession to establish and implement these new standards and accounting principles.

In addition to the Securities Act of 1933 and the Securities Exchange Act of 1934, Congress passed several other major pieces of legislation that had an effect upon the accounting profession and corporate finance during the 1930s, including the Public Company Utility Holding Company Act of 1935, the Maloney Act of 1938, and the Glass-Steagall Banking Act of 1933.[76] Through all of these acts, the federal government increased its influence over the financial reporting of most American businesses, and it attempted to address the omnipresent issues of financial misrepresentation through unsound accounting practices. The Securities Act of 1933 and the Securities Exchange Act of 1934 nonetheless had the largest effect upon accounting and financial reporting in comparison to these other acts, as they directly addressed accounting practices while the others did so much more indirectly.

---

[74] McCraw, 169.

[75] Barr, 89.

[76] McCraw, 170.

TRANSPARENCY

These various pieces of government legislation directly addressed the investing public's demand for increased transparency in financial reporting. The Securities Act of 1933, for example, mandated greater disclosure among companies issuing new securities to the public via newly-required registration statements.[77] These registration statements contained a description of the company's business, a description of the securities the company was offering, information about the company's management, and a set of certified financial statements.[78] The financial information contained in these registration statements had to undergo the audit of an independent public accountant who would then certify that the statements presented fairly the financial position of the company. These audited statements offered a greater level of assurance to the investing public about the quality of the information contained therein, increasing the transparency and reliability of these statements since the auditors had certified their accuracy.[79] Building off of this, the Securities Exchange Act of 1934 required annual reports and financial statements from companies with existing securities. These reports and financial statements contained information similar to the registration statements—a description of a company's business, information about its management, and a set of financial statements—but companies had to file these with the Securities and Exchange Commission each year. While the requirements under the Securities Act of 1933 offered investors a transparent illustration of a company's financial position at the time it was first offering securities, the Securities Exchange Act of 1934 gave investors ongoing access to timely financial information since companies filed

---

[77] McCraw, 169.

[78] U.S. Securities and Exchange Commission, *Registration Under the Securities Act of 1933*.

[79] Gary Previts, Peter Walton, and Peter Wolnizer, eds., *A Global History of Accounting, Financial Reporting, and Public Policy* (Bingley: Emerald Group Publishing, 2011): 116.

annual reports each year. Independent public accountants also had to audit these annual reports, again providing an increased level of reasonable assurance to the general public that the financial statements contained in these filings were free from material misstatement.[80]

The combination of the 1933 and 1934 acts greatly empowered the newly-created Securities and Exchange Commission to increase transparency going forward as well. Indeed, the Securities Exchange Act of 1934 required "timely, accurate accounting disclosure" as a "necessary condition for the proper functioning of capital markets.'[81] Unlike the Securities Act of 1933 which required a one-time disclosure prior to the issuance of new securities, the Securities Exchange Act of 1934 required corporations to provide updated financial statements on a periodic—usually quarterly—basis so that investors could consistently maintain an awareness of the ongoing financial position of these corporations. These quarterly filings served to provide interim financial updates between the filing of the annual reports that the Commission also required. A company's income statement had to disclose "the character of the charges, dividends, or other distributions made against its various surplus accounts" in the interest of providing clearer information to the investing public.[82] The Securities and Exchange Commission went on to require "substantial authoritative support" for any financial data contained in the financial statements through the issuance of Accounting Series Release 4 in 1938.[83] These Accounting Series Releases were authoritative publications by the Securities and Exchange Commission that created new reporting requirements, as in the case of Accounting Series Release 4 which required documented support for all financial information contained in a

---

[80] McCraw, 170.

[81] Thomas A. King, *More Than a Numbers Game: A Brief History of Accounting* (Hoboken: John Wiley & Sons, Inc., 2006): 60.

[82] Barr, 89-90.

[83] King, 60.

company's annual report.[84] Companies now needed to have accurate, supporting documentation for the values that it reported on its financial statements, which deterred companies from listing grossly inflated asset values on their balance sheets since they could not provide genuine support for these amounts. The financial information in annual reports was much more likely to be transparent and accurate since the Commission could request supporting documentation for any amounts in the financial statements. In other words, it became much more difficult for corporations to misstate their assets and income intentionally since they would have no "substantial authoritative support" for these amounts.[85] This publication also effectively gave the Securities and Exchange Commission the power to approve financial statements or deny them for being misleading due to a lack of substantive support.

CONSISTENCY

The various pieces of legislation also directly addressed the investing public's concern of consistency. The Securities Act of 1933, for example, required a standard registration statement that would help to make financial disclosures more consistent and constant from one company to the next.[86] Each company issuing new securities had to include the same major pieces of information plus audited financial statements in this registration statement, so investors could compare one company's registration statement to another's with relative ease. In addition, with

[84] These Accounting Series Releases were markedly different from the Accounting Research Bulletins that the Committee on Accounting Procedure issued between 1938 and 1959. Accounting Series Releases were publications that the Securities and Exchange Commission issued in an effort to streamline the way in which financial information appeared to investors in annual reports and financial statements. Accounting Research Bulletins were publications developed by the accounting profession itself through the Committee on Accounting Procedure. Through the use of these Bulletins, the profession dictated the method for calculating certain amounts like net income and asset values. In short, Accounting Series Releases were government-issued publications geared toward the appearance of financial information, while Accounting Research Bulletins were profession-issued publications aimed at computation of financial information, not the way in which it appeared.

[85] King, 60.

[86] McCraw, 170.

the passage of the Securities Exchange Act of 1934, Congress gave the Securities and Exchange Commission the ability to "prescribe the form or forms in which required information [would] be set forth" in financial disclosures, thereby requiring consistency from one company to the next.[87] The Securities and Exchange Commission now had the ability to specify how companies would report their financial information to the investing public, and the Commission did just that in 1938 with its adoption of Regulation S-X. Regulation S-X delineated the requirements for financial statements filed with the Securities and Exchange Commission, both with respect to form and content.[88]

Emerging from the investing public's critique of the varying presentations of assets, income, and other items on financial statements during the 1920s, the Securities and Exchange Commission obtained and utilized the power to make public companies report their financial information to investors in a consistent manner. The public had repeatedly argued for greater consistency and comparability from one company to another throughout the 1920s and into the early 1930s before the passage of federal legislation in 1933 and 1934. Investors, for example, deplored the massive overstatement of assets by $700,000 in the Fred Stern and Company scandal that severely misstated the company's financial position.[89] Similarly, the Interstate Hosiery Mills scandal of 1937 involved fraudulent accounting practices that inflated figures so heavily that nearly forty percent of the assets on the company's balance sheet were nonexistent.[90] While both of these examples involved major accounting fraud, they nonetheless demonstrated

---

[87] Barr, 89-90.

[88] King, 60.

[89] Knapp, 118.

[90] Jan R. Heier, Maria A. Leach-Lopez, and Marcia A. Leach-Lopez, "Development of Modern Auditing Standards: The Strange Case of Raymond Marien and the Fraud at Interstate Hosiery Mills, 1934-1937," *The Accounting Historians Journal* 37, no. 2 (2010): 79, http://www.jstor.org/ (accessed May 12, 2015).

the lack of any presentation rules that companies needed to apply consistently in their financial statements since these companies calculated and reported balance sheet amounts according to their liking. The investing public's disillusionment after scandals like these led to the Securities and Exchange Commission obtaining and utilizing the power to make public companies report their financial information to investors in a consistent manner via annual reports.

In addition, the Securities and Exchange Commission required that companies file these annual reports in accordance with "the most elementary principles of accounting."[91] Indeed, in an era where "equally well-respected" accounting firms calculated net income differently, the federal government sought to provide greater conformity to a uniform set of accounting principles that would enhance the comparability of financial statements across companies, regions, and industries.[92] For example, if two manufacturing companies had the same amount of income before the consideration of interest expense, and if one of these companies deducted this interest expense in the computation of net income while the other did not, the comparability of these net income amounts would suffer. A company that did not deduct its interest expense would appear to be more profitable than a company that did, even though the two companies had identical financial positions for the year. This lack of consistency in reporting practice created a need for uniform accounting principles that would ensure financial presentation was consistent from company to company. While determining what, exactly, comprised these uniform accounting principles would be a difficult task for both the accounting profession and the Securities and Exchange Commission in the two decades following the passage of the Securities Exchange Act of 1934, the government nonetheless demonstrated a commitment to consistency on at least a theoretical level in response to the demands of the investing public.

---

[91] Barr, 89-90.

[92] Mayer-Sommer, 30.

COMPETENCY

Finally, the government legislation in 1933 and 1934 was also a direct response to the investing public's concerns about competency within the accounting profession. The provisions of the Securities Act of 1933 held auditors to a much higher standard and increased the potential for severe auditor liability in the case of financial misstatement. Section 11(a) of the 1933 act enabled purchasers of newly-issued securities to hold auditors liable for material misstatements and omissions in a company's registration statement. Indeed, the act explained that if any portion of a registration statement contained such a misstatement or omission, "any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may…sue" the independent public accountant who audited that registration statement. Further, the burden of proof fell upon the defendant in these cases, not the individual plaintiff who sued to recover losses. Only after the auditor demonstrated due diligence in the conduct of an audit and indicated "reasonable ground to believe" that, when the registration statement took effect, "the statements therein were true and that there was no omission to state a material fact" would the auditor escape liability.[93] These provisions for increased liability considerably heightened the need for auditor competency. Auditors now had to act more carefully, be more thorough, and remain truly independent in order to avoid intense liability to investors, thereby necessitating an increase in competency within the profession.

As with the Securities Act of 1933, the Securities Exchange Act of 1934 addressed the issue of auditor liability as well. Under Section 10 of the Securities Exchange Act of 1934, investors could sue auditors in an attempt to recover losses relating to existing securities only

[93] O. Ray Whittington and Kurt Pany, *Principles of Auditing & Other Assurance Services* (New York: McGraw-Hill, 2014): 121.

when investors could prove the existence of scienter—a technical term indicating deliberate intent to deceive on the part of the auditor.[94] Likewise, under Section 18 of the 1934 act, auditors were liable to investors who sustained losses in the case of misstated financial statements, but only if those investors could prove that the auditors had not acted in "good faith."[95] While this language had a much more limited scope in comparison to the language of the 1933 act, this limitation derived from the different set of circumstances to which it applied. The 1933 act referred to companies issuing new securities, while the 1934 act applied to companies with existing securities. The language in the 1934 was not so much a step backward in the threshold for liability as it was a different standard for a different type of financial statement. Even though the Securities Exchange Act of 1934 generally shifted the burden of proof from the defendant auditor to the plaintiff investor in cases of losses from financial statement misstatements, it still heightened the need for competency on the part of accounting professionals. Without exercising and demonstrating the appropriate level of ability in the conduct of an audit, public accountants could easily open themselves up to substantial liability to investors who sustained losses. Through these provisions, the government was able to provide regulations that would respond to the public's demand for greater competency among accounting professionals by generating a threat of legal liability going forward.

In addition, the Securities and Exchange Commission required that the basic principles of accounting be "applied uniformly by all accountants," thereby requiring a minimal level of knowledge and ability among all members of the profession.[96] In order to be able to apply accounting principles appropriately, accountants needed a certain level of understanding of

---

[94] Whittington and Pany, 125.

[95] Whittington and Pany, 123.

[96] Barr, 89-90.

accountancy and thus a certain level of professional competency. Without a deep enough understanding of the ideas which they practiced, accountants would be unable to comply with the general requirements of the Securities and Exchange Commission following the legislation of 1933 and 1934. To address this, the accounting profession would need to develop a set of generally accepted accounting principles that accountants could apply uniformly. Because the Commission did not promulgate any such set of financial statements, this responsibility fell to the profession itself. In response to this need for consistent accounting principles, the Committee on Accounting Procedure American Institute of Accountants issued fifty-one Accounting Research Bulletins between 1938 and 1959 that established uniform accounting principles on an issue-by-issue basis.[97] Thus, the Commission required uniform accounting principles while the profession itself developed these principles in practice.

Coupled with this requirement of technical competency was the Commission's mandate that auditors remain wholly independent from the companies whose financial statements they examined. Indeed, pursuant to the Securities Act of 1933 and the Securities Exchange Act of 1934, only independent auditors—auditors outside of the corporation who were free from conflicts of interest—could certify the financial information contained in filings with the Securities and Exchange Commission.[98] This created a challenge for the profession due to the structure that had developed over time. Historian Stephen Zeff highlights how, "[f]rom the earliest days of the profession, accounting firms rendered consulting services" in addition to traditional audit services.[99] Only by remaining free from conflicts of interest could public

---

[97] King, 74.

[98] McCraw, 169.

[99] Stephen A. Zeff, "How the U.S. Accounting Profession Got Where It Is Today," *Accounting Horizons* 17, no. 3 (2003): 191, http://www.ruf.rice.edu/ (accessed December 2, 2015).

accountants perform the duties required of them by the Securities and Exchange Commission. In this sense, then, public accountants had to maintain competency in the form of unclouded judgment. This type of conflict of interest was apparent in the Interstate Hosiery Mills scandal of 1937. Raymond Marien—an external auditor—personally oversaw the bookkeeping and financial statement preparation for his audit client, Hosiery Mills. When he then had to audit the financial statements of the company, he effectively was reviewing his own work and was not able to issue a truly independent opinion.[100] Examples such as this illustrated the difficulty of balancing consulting and auditing work in the context of auditor independence. With the requirement for independent auditors in the 1933 and 1934 acts, accountants had to reevaluate and address this structural issue within the profession and separate the auditing function from the consulting function going forward. Government regulation thus responded to the demands of the general public by ensuring that accountants remained competent—both in terms of technical understanding and freedom from impaired judgment resulting from independence issues.

GOVERNMENT REGULATION IN PRACTICE

The Securities Act of 1933, the Securities Exchange Act of 1934, and the various other pieces of government legislation in the wake of the stock market crash of 1929 all increased the power of the federal government to regulate the finance and accounting professions in the United States. Through the vehicle of the Securities and Exchange Commission, the federal government quickly gained the ability to regulate accounting policy, practice, and procedure—all in response to the demands of the investing public who sought this regulation of professional accountancy. In theory, the government had immense control over the accounting profession. In practice,

[100] Heier, Leach-Lopez, and Leach-Lopez, 71.

however, the government did not actively interfere with—or intervene in—the accounting profession for several decades following the Great Depression.

After its inception in 1934, the Securities and Exchange Commission had ultimate authority over accounting practice and standards in the United States. However, under the leadership of Joseph P. Kennedy—the first chairman of the Securities and Exchange Commission who served from 1934 through 1935—the Commission did not actively grapple with accounting issues but instead focused on the more visible problems with the stock markets. Described by a fellow Securities and Exchange Commissioner as "a business man with a wide experience in the practical affairs of Wall Street," Kennedy used his past endeavors in corporate finance as a way to bring about change within the markets through a policy of cooperation with the finance industry.[101] He actively attempted to persuade corporations to issue new securities and paid little attention to accounting practices. Kennedy devoted such little energy to accounting issues, in fact, that on one occasion he quipped that he would "hate to go out of here thinking [he] had just made some changes in accounting practices" and nothing more.[102] Instead, he reassured the accounting profession that the Commission would not likely make use of its newly-granted power to regulate accounting principles and practices in the country but would instead adopt a policy of "moderation in exercising its power over accountants."[103] In all respects, Kennedy devoted minimal time to accounting reform and instead focused on other matters.

James M. Landis, the Securities and Exchange Commissioner to succeed Kennedy as chairman from 1935 through 1937, adopted a slightly different approach to accounting reform,

---

[101] Seligman, 108.

[102] Seligman, 117.

[103] Seligman, 116.

but even Landis did not actively reform the profession through full utilization of the powers of the Securities and Exchange Commission. Instead of ignoring accountancy entirely, Landis adopted a policy of cooperation with the accounting profession and presented a plan for "self-regulation" within the profession itself.[104] Under this plan of self-regulation, the Commission would have ultimate authority over accountancy, but the profession would remain largely in charge of its own policies and procedures. Even though the Commission could, for example, decide on the appropriate method of accounting for foreign operations and exchanges, it left this task to the profession under this policy of self-regulation. The profession, in turn, produced *Accounting Research Bulletin Number 4* that directly addressed this issue. While the Securities and Exchange Commission had the power to dictate appropriate methods for accountants to follow, it frequently left this for accountants to decide largely on their own.

Landis made use of existing institutions within the accounting profession as a way to effect change as well. He prompted the accountants to cooperate, and the professionals in the American Institute of Accountants created a Special Committee on Cooperation with the Securities and Exchange Commission in an effort to do just that.[105] This cooperation would ultimately help to resolve some of the outstanding issues in accounting policy and practice—such as computation and reporting methods—while actively working to address the concerns of transparency, consistency, and competency that predominated within the profession. Landis did make some advances, such as the creation of a subdivision within the Securities and Exchange Commission headed by a new Chief Accountant. This subdivision was responsible for issuing Accounting Series Releases that would serve as basic guidelines for accounting practice going

[104] McCraw, 187.

[105] McCraw, 190.

forward.[106] These publications dealt less with accounting concepts and more with presentational issues like the form of accountants' certificates.[107] On questions of accounting principles, the Commission continued to encourage self-regulation within the accounting profession.

The Securities and Exchange Commission made the largest—albeit, still limited—strides toward accounting regulation under William O. Douglas, who served as chairman immediately after Landis from 1937 through April of 1939. Douglas sought a more active approach and decided to "take the lead in formulating accounting principles as it was empowered to do under the 1933 Act."[108] Douglas actively attempted to leave behind the policy of self-regulation that Landis had championed, instead pushing for the Commission to treat accounting reform as a primary, rather than secondary, issue. Douglas directed the Commission's Chief Accountant to conduct studies of accounting practices in place at the time, but Douglas was never able to make good use of those studies to effect change since the Commission focused more heavily on general financial issues than it did on accounting practices.[109] Douglas was an active proponent of a uniform accounting framework that would utilize and address the results of these studies, but the Securities and Exchange Commission did not have adequate time to complete "the extensive research necessary to formulate the correct accounting principles" for application in all cases.[110]

---

[106] McCraw, 191.

[107] In the context of professional accountancy, presentational issues relate to how certain financial information appears, not how it is calculated. The wording of certificates, the structure of annual reports, and the appearance of financial statements were all issues that Accounting Series Releases addressed. The aim of the Securities and Exchange Commission was to address how this financial data appeared to the ultimate user—the investor—not how accountants themselves calculated the numbers that made up this financial data. The Commission dealt more with presentation, or appearance, than it did with computation.

[108] Seligman, 197.

[109] Seligman, 199.

[110] Seligman, 200.

Due to the impossibility of developing a uniform accounting framework, Douglas settled for smaller victories and sought to address specific issues, like the explanatory footnotes that were "so numerous that the statements were particularly confusing" as a result.[111] The Commission addressed this particular issue through Accounting Series Release No. 4, which toughened the footnote policy and required "substantial authoritative support" for items contained in the financial statements instead of winding and incoherent notes which investors could not easily understand. These Accounting Series Releases required the profession to present information clearly, thereby pushing the profession toward transparency without controlling the methods in which accountants calculated the financial information itself. The closest that the Douglas administration ever got to bringing about considerable change in accounting policy was through these Accounting Series Releases, which the Chief Accountant issued with the aim of "contributing to the development of uniform standards," not generating these standards unilaterally.[112] The Securities and Exchange Commission under Douglas addressed specific issues, one Accounting Series Release at a time. Setting those aside, little change occurred, and the profession remained largely self-regulating.

The government regulation of the accounting profession during the Great Depression was largely in appearance, not in practice. The government utilized various pieces of legislation like the Securities Act of 1933 and the Securities Exchange Act of 1934 that responded specifically to the requests of the public in areas of consistency, competency, and transparency. Out of this legislation came the Securities and Exchange Commission, the major vehicle by which the federal government had the power to regulate the accounting profession in the United States. The Commission, however, did not regulate the accounting profession as heavily in practice as it

---

[111] Seligman, 198.

[112] Seligman, 200.

could have. While the new reporting and auditing standards certainly required additional disclosure and adjusted practices among accounting professionals, these were moderate advancements considering the ultimate authority over accounting practice that Congress gave to the Securities and Exchange Commission. The federal government had the unilateral power to shape accounting theory and practice but instead adopted a policy of cooperation with the accounting profession that left much of the decision-making to the profession. Under the leadership of Landis and Douglas, the Commission left the profession to quasi-self-regulation; the Commission and the government worked closely with the profession to bring about change rather than mandating certain reforms. As a result, the Securities and Exchange Commission primarily offered guidance through Accounting Series Releases and other general directives, while the major changes and reforms occurred within the profession itself. It was in this context that accountants themselves—through their existing institutions, culture, and practices—endeavored to improve their policies and repair their image in the eyes of the general public that had so vehemently criticized them a few years before.

THE PROFESSION RESPONDS: REFORMING ACCOUNTING POLICY AND PRACTICE

The accounting profession had a variety of reactions to the regulation of the federal government following the stock market crash of 1929. While the profession did address the outcry of the investing public, it did so indirectly through their responses to publicly-supported government regulation. In addressing these regulatory efforts and the public opinions which they represented, the members of the accounting profession fell primarily into two major groupings—those who outwardly opposed government regulation, preferring self-regulation, and those who supported the government regulation for the new business opportunities which it presented, given the increased demand for independent accountants. While the thought process of each subgroup within the profession was slightly different, the accounting profession as a whole did agree that some kind of action had to be taken to assuage the concerns of legislators, investors, and the financial community. As such, in conjunction with the self-regulatory initiatives of the Securities and Exchange Commission, the accounting profession directly responded to the issues of consistency, transparency, and competency that so heavily influenced the legislation passed in 1933 and 1934. Through use of Accounting Research Bulletins issued by the Committee on Accounting Procedure, various publications by the American Institute of Accountants, and new policies that addressed professionalization and inadequate procedures, the accounting profession actively took part in the Securities and Exchange Commission's policy of self-regulation and thus addressed the issues that were of primary concern to legislators and the investing public at the time.

While all accountants could agree on the virtues of self-regulation, not all viewed the regulatory efforts of the federal government and the Securities and Exchange Commission very favorably. Some accountants, for example, sought to "forestall federal intervention" in any way possible, as "most practitioners" viewed autonomy positively.[113] Even though the Securities and Exchange Commission adopted a policy of cooperation with the accounting profession based primarily on self-regulation, some accountants believed that the federal government should not even have the opportunity or ability to involve itself with professional accountancy. Although the Commission had not chosen to be heavily involved in regulating the accounting profession, it nonetheless had the ability to do so much more strictly going forward and could dictate the path which the profession would have to follow.[114] On top of this, many accountants believed that the regulatory efforts of the federal government were "confusing" to the public and to investors, thereby muddling the goal of further clarity for these stakeholders.[115] While the public expected the government to make sweeping changes to accounting practice, the more gradual approach through the Commission's Accounting Series Releases and its support of self-regulation fell short of public expectations and left them confused as to who was actually regulating the profession. Some accountants, then, were opposed to any sort of regulation, while others contended that the existing regulatory efforts merely clouded and confused the issue among the major party seeking reform—the investing public. For this subset of accountants, other methods, such as autonomous self-regulation, were preferable.[116]

---

[113] Previts, Walton, and Wolnizer, 116.

[114] Barr, 89.

[115] Paul Peretz and Jean Reith Schroedel, "Financial Regulation in the United States: Lessons from History," *Public Administration* 69, no. 4 (2009): 605, http://www.jstor.org/ (accessed May 12, 2015).

[116] Previts, Walton, and Wolnizer, 116.

Conversely, other accountants viewed the federal government's regulatory efforts much more positively due to the numerous business opportunities that these efforts created. Because the Securities Exchange Act of 1934 required that publicly traded companies have their financial statements audited by independent public accountants, the act created a crucial role for accountants in business and society.[117] No longer were accountants hidden from the public view and visible only in the financial statements which they produced. Rather, these accountants now played a pivotal role in the financial reporting and assurance process where they were so integral to enhancing the quality of the financial information reported by public companies. As such, some accountants—though perhaps displeased with the increased regulation of their profession—recognized that this regulation in 1933 and 1934 ensured that the profession would continue, serve an integral role, and have ongoing opportunities for revenue and employment going forward.

In addition, the Securities Exchange Act of 1934 helped to professionalize public accounting by making it a more in-demand, highly visible profession in front of the general public. Historian Michael Doron contends that the passage of the Securities Act of 1933 and the Securities Exchange Act of 1934 was "the single most important event in the professionalization of accounting" since these acts "legitimized the profession."[118] In keeping with this idea, some accountants acknowledged that these acts "resulted in increased prestige for the public accounting profession, and enlarged their responsibility to shareholders and to the general public alike."[119] With this increased prestige and responsibility, accountancy was no longer a minor

---

[117] McCraw, 169.

[118] Michael E. Doron, "'I Ask the Profession to Stand Still': The Evolution of American Public Accountancy, 1927-1962," *The Accounting Historians Journal* 38, no. 1 (2011): 119, http://www.jstor.org/ (accessed May 11, 2015).

subset of corporate finance that existed exclusively within the corporate environment in the eyes of the public. Rather, it became increasingly prominent and integral to the workings of the investing process, and accountancy became much more of a profession than a business function. Accountants and auditors—like doctors, lawyers, and other similar individuals—now had a responsibility to the public as a profession, not just as individuals. This government regulation thus enhanced accountancy and helped it become a necessarily professionalized element of financial reporting.

Finally, accountants viewed this regulation favorably in some respects due to the support that it offered for auditor independence. Indeed, the Securities Act of 1933 and the Securities Exchange Act of 1934 provided auditors with "the leverage to resist the demands of their corporate clients" in their integral role of auditing financial statements in filings with the Securities and Exchange Commission.[120] Previously, clients could sway their auditors and accountants to accept improper financial statement presentation just to ensure that their firms received the revenue associated with finishing these audit engagements.[121] Many public accountants and auditors viewed the 1933 and 1934 legislation favorably, as it finally empowered the accounting profession to maintain its independence and avoid the influence of the senior management of the companies which they audited. Auditors now had a direct responsibility to the investing public that the federal government outwardly supported.

Irrespective of the positive and negative views of accountants across the country, the legislative efforts of the federal government—in conjunction with the efforts of the Securities

---

[119] Charles W. Wootton and Carel M. Wolk, "The Development of the 'Big Eight' Accounting Firms in the United States, 1900 to 1990," *The Accounting Historians Journal* 19, no. 1 (1992): 10-11, http://www.jstor.org/ (accessed May 11, 2015).

[120] Doron, 119.

[121] "Exchange Rulings," *New York Times*, April 12, 1933.

and Exchange Commission—prompted the accounting profession to take action. The profession did react to the major areas of consistency, transparency, and competency that the investing public targeted so heavily; however, the way in which the profession addressed these issues was more indirect than it was direct. Indeed, accountants responded primarily to the initiatives of the Securities and Exchange Commission and the legislation itself which enveloped and embodied these complaints of the general public, not to the general public directly. Nonetheless, in its various actions following the stock market crash of 1929, the accounting profession took great care to improve consistency in financial reporting, increase transparency in financial statements, and ensure that accountants and auditors competently performed their duties to the financial community and the investing public.

Although the profession responded more indirectly than directly, the public clearly saw the results of the profession's efforts. Public readership of the profession's Accounting Research Bulletins was limited, but the effects of these bulletins were apparent in the improved financial statements that companies began to issue. Financial statements became more consistent in both presentation and computation, so these statements thus possessed a greater level of comparability from one company to the next. Financial statements became more clear and transparent, thereby increasing their usefulness to investors. Most investors therefore did not see the textual responses of the profession but instead saw the highly visible effects of these responses in the form of new and improved financial statements.

CONSISTENCY

In its efforts to address the issue of consistency, the profession established the Committee on Accounting Procedure, a body which set accounting principles throughout the United States from its inception in 1938 to its termination in 1959.[122] The Committee, which was a subset of the American Institute of Accountants, consisted of twenty-two members—eighteen from public accounting firms, three from academia, and one from the Securities and Exchange Commission.[123] The Committee thus responded to the self-regulatory initiatives of the Securities and Exchange Commission and sought to cooperate directly with the Commission by including Securities and Exchange Commission representation on the Committee itself. During its twenty-year life, the Committee on Accounting Procedure issued fifty-one separate Accounting Research Bulletins that addressed the treatment of specific topics like income taxes and intangible assets. The profession used the Committee to tackle the problems of consistency and uniformity one issue at a time, primarily through its issuance of these Accounting Research Bulletins that slowly worked their way into practice. The Committee did not supply a conceptual framework to provide general accounting guidance.[124] Because of the lack of a conceptual framework, some diversity in accounting practice remained.[125] In spite of this, the accounting profession exerted considerable effort to achieve uniformity and address the complaints and criticisms of investors and legislators alike. More importantly, by taking these active measures, the accounting profession and the Committee on Accounting Procedure "avoided some

---

[122] Seligman, 420.

[123] King, 73.

[124] A conceptual framework is an underlying set of concepts and objectives that serve as the foundation for financial reporting. While this type of conceptual framework exists today due to the initiatives of the Financial Accounting Standards Board, no such framework existed in the first half of the twentieth century. Today, the conceptual framework includes elements like completeness, neutrality, and full disclosure. Immediately following the Great Depression, there was no similar set of uniform principles upon which accountants could rely. Instead, accountants had to extrapolate based on specific rules for specific accounting issues like income taxes or inventory, which led to greater variation in accounting practice.

[125] King, 74.

proliferation of methods that would have occurred if they had not acted" at all, such as aggressive government regulation instead of self-regulation.[126]

One major example of this approach was *Accounting Research Bulletin Number 8*, entitled "Combined Statement of Income and Earned Surplus." Because of the major variances in practice on what accountants should include in income, how they should calculate income, and how they should present income in financial statements, the Committee issued this Accounting Research Bulletin in February of 1941. This bulletin gave "consideration to the general form of the income statement, with particular reference to the question of the influence of form upon effective presentation" for the purposes of adequately informing the investing public. In a study of annual reports from 500 corporations, the Committee noted that substantial variance occurred from company to company with respect to showing income and earned surplus on a single statement, in "two related exhibits on a single page of the published report," or on two entirely separate statements.[127] This Accounting Research Bulletin did not focus as heavily on how accountants should calculate income as it did on how accountants should present income. This publication sought to generate consistency in the context of appearance and presentational format. Without having a consistent form of income statement presentation, it was considerably more difficult for investors to compare one company's financial data to another's without substantial added work. This attempt at reform by the Committee on Accounting Procedure enhanced the comparability of financial information and the consistency of presentation from one company to the next as accountants began to implement these ideas.

[126] Lawrence L. Vance, "The Road to Reform of Accounting Principles," *The Accounting Review* 44, no. 4 (1969): 699, http://www.jstor.org/ (accessed May 11, 2015).

[127] *Accounting Research Bulletin No. 8* (1941): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

In addition, the Committee issued numerous Accounting Research Bulletins with the same title of "Report of Committee on Terminology" in the years from 1940 through 1944. Each of these bulletins addressed consistency in the context of a particular item of terminology with the ultimate goal of defining this item for consistent use from one company to the next and from one accounting firm to the next. Indeed, as outlined in *Accounting Research Bulletin Number 7*, the Committee addressed "the specialized usage in accounting of common terms" such as "value," "assets," and "liabilities." By addressing the usage of these terms in a manner "more extensive than mere definitions" that would "include suggestions for modifications of present practice," the Committee directly sought the consistent use of terminology to avoid confusion both within the profession and outside the profession among the general public.[128] Similarly, in *Accounting Research Bulletin Number 9*, the Committee on Accounting Procedure addressed several of these terms which were "of great importance to accountants" but "over which confusion [arose]" because of such frequent use "in a technical as well as a popular sense." Among the terms that the Committee addressed in this bulletin were "assets," "liabilities," "income," "profit," "audit," and "auditor's report," along with several others. As with previous bulletins, the Committee sought not only to clarify the meaning of certain terms in both an accounting and general context, but also to ensure consistent interpretation by "all who prepare or use accounting statements."[129] Bulletins such as these were relevant to the accounting profession and also to the users of the financial information that accountants generated—the investing public. Although investors rarely interacted directly with these bulletins, the practices in these bulletins reached investors through their impact on the methods used in various companies' financial statements. The bulletins did not target the public as their audience, but

[128] *Accounting Research Bulletin No. 7* (1940): 2, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[129] *Accounting Research Bulletin No. 9* (1941): 2, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

investors saw the effects of these bulletins in the more consistent and comparable financial statements that companies were beginning to issue. Investors saw a greater quality of information in corporate financial reporting and were increasingly able to compare the information among many companies. It was not the wording of the bulletins that reached the public, but instead the effects on accounting practice that became apparent to investors.

Later bulletins also addressed these issues of terminology. Indeed, *Accounting Research Bulletin Number 12* acknowledged that the "reappraisal of assets and the revaluation of surplus often associated therewith" produced computational and presentational issues for users of financial statements. With inconsistent valuation and presentation from one company to the next and from one accounting firm to the next, the comparability of financial information suffered. In fact, the Committee on Accounting Procedure went so far as to acknowledge that even though "both the practice and the terminology [were] now discredited, their influence on the public thinking [was] still felt" across the country.[130] The Committee issued such bulletins in response to this confusion in order to address the issue raised by the general public and ensure consistency in principle and practice. Likewise, subsequent bulletins addressed the issue of "accounting for fixed assets" and the use of the term "depreciation" in a "specialized sense" so as not to mislead the investing public. *Accounting Research Bulletin Number 16*, for example, addressed seven differing definitions of "depreciation" and clarified for preparers and users of financial statements the appropriate definition and approach to utilize. Indeed, by emphasizing that depreciation did not "describe downward changes of value regardless of their causes," this bulletin addressed the divergence of interpretation and the inconsistent use among practitioners of accountancy, and it sought to move all parties involved toward a consistent understanding that

[130] *Accounting Research Bulletin No. 12* (1941): 2, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

would ensure comparability from one set of financial statements to the next.[131] It was through these clarifications that the Committee sought to ameliorate "[m]uch of the confusion and many of the misapprehensions that [had] arisen in respect of depreciation accounting" and the corresponding definitions of relevant terms.[132]

The Committee on Accounting Procedure directly addressed the issue of "consistency" in its 1944 *Accounting Research Bulletin Number 22*. Writing after several years of addressing specific terms and definitions, the Committee contended that the phrase "in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year" had major implications for comparability and similar practice from one year to the next. The Committee did clarify, however, that "consistency" did not necessarily entail using the exact same accounting treatment for a certain item each year "if the situation with respect to that element has materially changed."[133] This consistency became apparent to the investing public in the financial statements that companies issued, as investors now saw enhanced comparability in these statements as time progressed. While much of the emphasis on consistency related to its use as a term, the fact that this term was so highly important that it appeared in the Committee's publications nonetheless indicated its great importance in the accounting profession in response to the concerns of the general public and government legislators. From this emphasis on consistency to the Committee's recommendation "that the use of comparative statements be extended," the accounting profession made every effort to reinforce standard reporting practices from one company to the next.[134] With its focus on comparability, constancy, and overall

---

[131] *Accounting Research Bulletin No. 16* (1942): 3, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[132] *Accounting Research Bulletin No. 20* (1943): 4, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[133] *Accounting Research Bulletin No. 22* (1944): 3, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[134] *Accounting Research Bulletin No. 6* (1940): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

similarity in practice from company to company, the accounting profession—through the vehicle of the Committee on Accounting Procedure—addressed the major concern of consistency among the investing public. By providing definitions of certain items for application in all situations and by emphasizing the use of certain types and forms of statements that would enhance comparability, the Committee and the profession sought to increase consistency for both accountants themselves and the public as a whole.

TRANSPARENCY

The accounting profession also addressed the issue of transparency in financial reporting that was so significant to the investing public in its attempts to make informed decisions about numerous companies and investment opportunities. As with the issue of consistency, the profession primarily addressed transparency through the Committee on Accounting Procedure and its various Accounting Research Bulletins. While some of these bulletins sought to enhance consistency in reporting practice, others had the ultimate goal of improving transparency in the disclosure of financial information to assuage the concerns of legislators and investors alike. This was in direct response to the opacity of information that had predominated in the years leading up to the stock market crash.

In *Accounting Research Bulletin Number 5*, for example, the Committee on Accounting Procedure addressed the issue of depreciation and asset valuation. In the interest of properly reporting asset values without overstating these assets and misleading investors, the Committee explained that "[a]ccounting for fixed assets should normally be based on cost," as well as that appreciation "should not be reflected on the books of account of corporations."[135] In the interest of addressing the major issue of asset write-ups and the corresponding opacity of financial

[135] *Accounting Research Bulletin No. 5* (1940): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

information relating to these write-ups, the Committee sought to reinforce the concept of historical cost in asset recognition and reporting. By reporting assets at their purchase price, companies could convey financial information to the users of this information on a clear and consistent basis that represented one concrete value of historical cost. Companies would not be able to increase the values of their assets on their financial statements arbitrarily in an attempt to adjust to ever-changing market prices. For example, a company could not double the value of an asset on its financial statements even if the selling price for that particular asset doubled in the market. In simple terms, assets usually appeared on a company's financial statements at the price for which the company acquired them, except for cases where the assets declined in value and accountants had to write these asset values down on the company's financial statements.[136] Initiatives such as these would ensure that there was minimal subjective valuation that could mislead investors while providing a clear and transparent understanding of what reported amounts represented without the effect of subjective write-ups in asset value.

Likewise, the Committee sought to provide greater transparency in financial reporting relating to other highly pertinent issues at the time, such as the reporting of dividends—particularly stock dividends—in financial statements. The investing public previously pushed for companies to report items such as stock dividends and stock split-ups in a comprehensible way and to disclose the accounting method used.[137] In the interest of providing clear, unambiguous rules relating to these stock dividends, the Committee issued a "Statement of Accounting Principles as to the Issuing Corporation" in the case of stock dividends in *Accounting Research*

---

[136] This concept of writing asset values down but not up is in keeping with accounting conservatism—the idea that future losses should be recognized immediately while future gains resulting from increases in value should be deferred until there is assurance of receiving that gain. Companies therefore write assets down when their market value declines, but they do not increase the value of assets when their market value increases. Under the concept of accounting conservatism, it is better to understate, rather than overstate, financial information. So, accountants tend to recognize uncertain losses immediately and wait to record uncertain gains from ever-changing market conditions.

[137] "As to Stock Dividends," *New York Times*.

Bullletin Number 11. In this bulletin, the Committee provided direct instructions to corporations issuing stock dividends about how to "determine the aggregate amount to be transferred from earned surplus," how to "observe the legal requirements as to the per-share amount to be capitalized," and how to determine the appropriate amounts for allocation to the required accounts.[138] Even though the average investor did not necessarily understand the precise details of the accounting for stock dividends, he or she nonetheless sought an understandable, transparent disclosure of these dividends given the accounting profession's past history of only opaquely reporting the issuance of these dividends. Through Accounting Research Bulletins such as these, the profession addressed transparency issues on a topic-by-topic basis while exercising care to touch upon the most significant and controversial reporting topics at the time. Investors began to see change as these transparency issues became less prominent in financial statements.

The Committee on Accounting Procedure also addressed several timely and highly relevant issues in financial reporting relating to—and often resulting from—World War II. For example, the Committee addressed the issue of accounting for reserves resulting from World War II in *Accounting Research Bulletin Number 13* and directed accounting professionals to appropriately disclose such reserves "by charges in the current income statement, properly classified, for all foreseeable costs and losses applicable against current revenues."[139] Further, the Committee addressed the issue of renegotiation of war contracts, another major issue arising out of World War II, in *Accounting Research Bulletin Number 15* in 1942. Similar to its treatment of reserves in *Bulletin Number 13*, the Committee clarified the treatment of renegotiated war contracts and explicitly indicated that "accountants were urged" to treat these items properly "not only in the interests of the business enterprise, but in the interests of the

---

[138] *Accounting Research Bulletin No. 11* (1941): 2, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[139] *Accounting Research Bulletin No. 13* (1942): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

national economy as a whole."[140] Finally, the Committee on Accounting Procedure addressed a final war-related item in *Accounting Research Bulletin Number 17* relating to "excess-profits tax" and any refunds associated therewith. This bulletin described appropriate reporting methods in the income statement, but also—and most importantly—emphasized the necessity of "appropriate disclosure as to each such amount" relating to the excess-profits tax itself.[141] In all of these respects, then, the accounting profession placed particular emphasis on disclosure and explanation, not on the technical solutions themselves. By requiring appropriate disclosure "in the interests of the national economy" and the entire investing process, the accounting profession actively responded to the demands for greater transparency that came from the investing public and the regulators in the federal government.[142]

Thus, while some of the Accounting Research Bulletins touched on standard reporting issues like depreciation and stock dividends, others addressed issues that were pertinent and pressing at the time of release. In all cases, however, the emphasis was on adequate disclosure of method so that investors and other users of the financial statements understood how accountants computed certain complex or atypical values. These sentiments appeared in other major publications at the time as well. Published in 1936, the American Institute of Accountants' *Examination of Financial Statements by Independent Public Accountants* acknowledged the "increased emphasis on accounting principles" and on "fuller disclosure of the basis on which accounts are stated" due to "the prominence given to such matters in regulations of the Securities and Exchange Commission."[143] Likewise, the American Institute of Accountants also issued *A*

---

[140] *Accounting Research Bulletin No. 15* (1942): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[141] *Accounting Research Bulletin No. 17* (1942): 1, http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

[142] *Accounting Research Bulletin No. 15*, 1.

Statement of Accounting Principles in 1938, which further emphasized the necessity of accounting principles that would better enable accounting professionals to "fully disclose the circumstances" surrounding particular items.[144] In these various publications, then, the accounting profession responded to the desires of the general public—as embodied in the actions of the Securities and Exchange Commission—for greater disclosure and transparency in financial reporting so that interested parties could better approach and understand the financial information of various companies.

COMPETENCY

The final area where the accounting profession underwent significant self-regulation and reform was the competency of its practitioners. Following the complaints of the investing public about auditor independence and the requirements of the 1933 and 1934 pieces of federal government legislation requiring audits by independent public accountants, the accounting profession actively sought to address the major issue of competency and independence. Unlike the areas of consistency and transparency which the profession addressed through Accounting Research Bulletins, the issue of competency required much more active reform within the profession. In its efforts to achieve this end, the profession utilized three main methods to address competency—ensuring professional certification, rebuilding the profession's image in the eyes of the public, and revising auditing procedures to correct issues from major scandals.

First, with respect to professional certification, the accounting profession took major steps to ensure that its practitioners had appropriate education and passed certification

---

[143] *Examination of Financial Statements by Independent Public Accountants* (New York: American Institute of Accountants, 1936), v.

[144] Thomas Henry Sanders, Henry Rand Hatfield, and Underhill Moore, *A Statement of Accounting Principles* (New York: American Institute of Accountants, 1938), 14.

requirements for public accounting. In 1927, the investing public viewed the accountant not "as a member of a learned profession but only as a skilled laborer."[145] As a result, the profession began to tighten some of the restrictions and requirements for becoming a certified public accountant. In New York, for example, an individual needed to have seven to ten years of accounting experience, a high school diploma, United States citizenship, and passage of the certified public accounting examination—an examination which had a nine percent passage rate at the end of 1929.[146] By requiring this examination and maintaining its difficulty in the years following the government regulation, the accounting profession continued to ensure that its practitioners had at least a minimum level of qualification and certification. Also, through membership in professional organizations like the American Institute of Accountants and the American Society of Certified Public Accountants, public accountants had to abide by a code of ethical conduct "designed to restrain the inevitable minority among professional men from encroaching on the rights of others, and from performing improper services" in their duties as public accountants.[147] While some of this professionalization of the accounting profession began before the stock market crash in 1929, the profession continued this trend and maintained the strict requirements for becoming a certified public accountant in the wake of the crash and corresponding government regulation as a way to demonstrate continued competency—especially in a new era where the capable, independent public accountant was required by the Securities Exchange Act of 1934.[148]

[145] Mayer-Sommer, 27.

[146] Mayer-Sommer, 25.

[147] Mayer-Sommer, 26.

[148] McCraw, 169.

In addition, the profession took active steps to rebuild its image nationwide through the American Institute of Accountants. In the 1930 report of the Secretary of the American Institute of Accountants, for example, the Institute emphasized the need to enforce "rules of propriety and good taste" among accountants that would hopefully "increase the respect in which the accountancy profession [was] held by the business public" in the aftermath of the market crash. The American Institute of Accountants also emphasized the need for appropriate conduct that would "ever retain the respect of those whose interests" the accounting profession served.[149] Thus, even without the imposition of formal regulation by the federal government, the profession began to regulate itself more heavily so as to regain the public confidence, address the issues highlighted in publicized responses, and ultimately repair its image. This was the beginning of a long campaign to demonstrate that the accounting profession was respectable, capable, and competent—even in the aftermath of the stock market crash and the Great Depression.

Finally, the profession began to revise auditing procedures in the wake of major scandals like those relating to McKesson & Robbins in 1938, Hosiery Mills in 1937, and Fred Stern & Company in 1924. In the McKesson & Robbins case, the auditing firm—Price, Waterhouse and Company—did not discover the "gross overstatement of assets and of earnings" because the auditing firm "had failed to employ that degree of vigilance, inquisitiveness, and analysis of the available evidence necessary in a professional undertaking."[150] Likewise, in the highly publicized Interstate Hosiery Mills fraud case, one auditor agreed to handle personally all of the financial statement preparation for one of his auditing clients. Thus, when subsequently auditing Interstate Hosiery's financial statements, this auditor effectively reviewed his own work and

---

[149] American Institute of Accountants, *1930 Year Book of the American Institute of Accountants* (1930), 122.

[150] Edwards, "Public Accounting in the United States from 1928 to 1951," 450.

could not offer an unbiased opinion.[151] Finally, in the Fred Stern & Company case, the auditing firm—Touche, Niven, & Co.—did not discover a gross overstatement of revenue and receivables in spite of a history of erroneous account balances. Although Touche was not technically liable to a third party for ordinary negligence due to technical legal issues, this case demonstrated a severe lapse in competent judgment on the part of the auditor.[152] These and other similar cases not only decreased the legitimacy of some companies' financial data but also decreased public confidence in the accounting profession when news of these cases spread across the country, prompting the profession to address the major issues of auditor competency and independence.

In response to some of these scandals, the profession issued and emphasized *Examination of Financial Statements by Independent Public Accountants*, which addressed many major elements of the audit process and the adequate performance of these elements. While this publication summarized some of the major auditing procedures, it also was an attempt by the accounting profession to increase auditor capability, independence, and competency. By increasing auditor understanding and ability, the profession was able to increase perceived—and actual—competency going forward. The profession's new emphasis on independence, a subset of an auditor's competency and ability to do his or her job, occurred largely in response to the Securities Exchange Act of 1934 and the government's push for independent accountants. Overall, the profession responded both to government regulation and directly to the outcry of the general public through its attempts to make accountants and auditors more capable and competent. Indeed, through an emphasis on improving auditor capability through certification requirements, increased independence, and improved audit processes, the profession attempted to repair its public image and demonstrate competency before the general public and the

[151] Heier, Leach-Lopez, and Leach-Lopez, 73.

[152] Knapp, 118.

government regulators who left the profession to self-regulatory measures. Investors saw these effects in the improved financial statements that companies began to issue, as the financial information that these statements contained was now more clear, consistent, and comparable—making them more useful and beneficial to investors.

CONCLUSION: ACCOUNTING REGULATION THEN AND NOW

In addition to its almost immediate effect on the accounting profession in the 1930s, the sequence of events from public outcry to government regulation and self-regulation also had another major impact in American financial history—the establishment of a new precedent for financial regulation. The Securities Act of 1933 and the Securities Exchange Act of 1934 set a precedent for government regulation of the accounting profession that made possible—and practical—the much more severe government regulation that occurred in 2002 with the Sarbanes-Oxley Act. The Sarbanes-Oxley Act was "the most sweeping federal securities legislation since the original laws in 1933 and 1934," and the implications for the accounting profession were even stricter.[153] Just as regulation and reform under the Securities Act of 1933 and Securities Exchange Act of 1934 occurred in the wake of major scandals like McKesson & Robbins and Hosiery Mills in the 1920s and 1930s, the regulatory efforts of the early 2000s appeared following scandals of an even larger magnitude including Enron, WorldCom, and Sunbeam.[154] Each of these scandals involved the use of fraudulent or unorthodox accounting practices to present the financial statements of the companies involved improperly, primarily through a manipulation of assets and net worth. As a result of these scandals, the investing public—misled by the confusing and often fraudulent accounting practices of the late 1990s—demanded stricter regulation of the accounting profession. Unlike in 1934, however, the

[153] Henry N. Butler and Larry E. Ribstein, *The Sarbanes-Oxley Debacle: What We've Learned; How to Fix It* (Washington, D.C.: AEI Press, 2006), 1.

[154] Butler and Ribstein, 7.

government bypassed the method of cooperation with the accounting profession and instead implemented strict regulatory provisions—both in appearance and in practice.

The Sarbanes-Oxley Act created the Public Company Accounting Oversight Board to oversee the profession, bringing the era of self-regulation to a close. Other reforms, like heavier penalties for corporate fraud and restrictions on the types of services that public accounting firms could offer without impairing independence, emerged as well.[155] Unlike the Securities and Exchange Commission, the Public Company Accounting Oversight Board remains much more heavily involved in the regulation and oversight of public accounting, and it certainly has not left the accounting profession to regulate itself. Instead, the Public Company Accounting Oversight Board has the authority to "register and monitor CPA firms" throughout the United States.[156] The Public Company Accounting Oversight Board conducts inspections of major public accounting firms, addresses quality control issues in these firms, and subsequently makes these criticisms available to investors and the general public. Unlike the hands-off guidance of the Securities and Exchange Commission in the 1930s and 1940s, the strict oversight of the Public Company Accounting Oversight Board is considerably more intense and aggressive. This Board essentially audits the auditing firms and endeavors to hold them accountable to prevent any further corporate accounting scandals.

Law Professors Henry Butler and Larry Ribstein contend that, in keeping with "the philosophy of the original 1933 and 1934 federal securities acts, [Sarbanes-Oxley] increases mandated disclosure in several areas" under Section 404 on internal controls disclosures.[157] This section of the act required stricter audit procedures and increased the level of disclosure about

[155] Whittington and Pany, 10.

[156] King, 205.

[157] Butler and Ribstein, 38.

internal controls in a company's financial statements. Sarbanes-Oxley thus had a focus on disclosure that was very similar to that of the 1933 and 1934 legislation, but the federal government ensured adequate enforcement of this focus through the Public Company Accounting Oversight Board. Only by improving transparency through adequate disclosure, acting with due professional care and competency following the financial reporting scandals of the early 2000s, and employing reasonably consistent methods in the conduct of audits could the accounting profession address the major criticisms of the investing public and the requirements of the federal government. Thus, the same issues of consistency, competency, and transparency remained as relevant in 2002 as they were in 1929. The controversial regulations imposed by the federal government in the 1930s thereby set an important precedent that legislators utilized and built upon in 2002 with the passage of the equally controversial Sarbanes-Oxley Act.[158]

Following the stock market crash of 1929, then, the accounting profession underwent a dynamic period of change, regulation, and reform. The financial collapse and the uncertainty surrounding that collapse prompted a vehement public response to the shortcomings of corporate finance and accountancy in the United States. Through numerous highly-publicized articles in newspapers like the *New York Times* and the *Wall Street Journal*, the investing public—reeling from the losses of the crash—ensured that its voice resonated across the country and demanded substantial reform in accounting policy and practice. Based on the issues of opacity of information, inconsistency in practice, and a lack of competency among accountants and auditors that predominated in the years leading up to the stock market crash, investors outwardly pushed for regulation of the profession that would address these major areas. In short, the public sought legislation, regulation, and reform that would improve and enhance essential characteristics of transparency, consistency, and competency in the practice of professional accountancy.

[158] Butler and Ribstein, 1.

In response to this outcry of the investing public, the federal government passed considerable legislation in the 1930s that encompassed and addressed the major issues highlighted by investors. Particularly through the Securities Act of 1933 and the Securities Exchange Act of 1934, the federal government mandated—at least in theory, if not in practice—consistency, transparency, and competency for accountants in the United States. As a result of this legislation, the newly-created Securities and Exchange Commission could "prescribe the form or forms in which required information [would] be set forth" and required consistency in reporting from one company to the next in terms of both annual reports and accounting methods used. Likewise, the Commission could require that income statements disclose "the character of the charges, dividends, or other distributions" in the interest of providing clearer, more transparent information to the investing public. Finally, the Commission had the power to demand that basic accounting principles be "applied uniformly by all accountants" and required a minimal level of knowledge among all members of the profession.[159] The 1933 and 1934 legislation went even further to create stricter liability requirements as a way to encourage a minimum level of competency among auditors that would thereby necessitate the performance of an audit with due diligence.[160] Through the provisions of these and other pieces of legislation, the federal government responded directly to the outcry of the investing public and created provisions that addressed the specific issues of transparency, consistency, and competency within the accounting profession. Irrespective of how the Securities and Exchange Commission enforced these various provisions, the government made a concerted effort to address the specific issues raised by the general public in the way regulators crafted the 1933 and 1934 legislation.

---

[159] Barr, 89-90.

[160] Whittington and Pany, 121.

The regulatory efforts of the federal government existed more in theory and appearance than they did in practice. Although the Securities Act of 1933 and the Securities Exchange Act of 1934 greatly empowered the government to regulate professional accountancy through the vehicle of the Securities and Exchange Commission, the Commission itself did not take active steps to regulate the profession very heavily. Instead, the Commission adopted a policy of cooperation with the accounting profession under the initiatives of Kennedy, Landis, and Douglas during their respective terms as chairmen of the Commission.[161] Landis in particular promoted a plan for "self-regulation" within the accounting profession itself, and he intended to provide minimal federal oversight of accountancy in practice.[162] The regulation of the federal government existed only in name and design, not in practice. While legislators crafted the Securities Act of 1933 and the Securities Exchange Act of 1934 in such a way that it would respond to the concerns of the investing public, the regulators themselves did not actively apply or enforce these various items following the passage of such legislation. As such, under this new policy of self-regulation, the majority of reform efforts fell to the accounting profession itself.

Actively embracing the policy of guided self-regulation, the accounting profession took care to address the three major issues of transparency, consistency, and competency. Through the creation of the Committee on Accounting Procedure and this Committee's subsequent issuance of numerous Accounting Research Bulletins from 1938 through 1959, the profession addressed consistency and transparency on an issue-by-issue basis. By touching upon issues relating to terminology and presentation in various bulletins, the profession attempted to correct the inconsistency in reporting and understanding that plagued the profession leading up to the stock market crash. Likewise, by commenting on certain specific computational and presentational

---

[161] Seligman, 116.

[162] McCraw, 187.

items like depreciation and stock dividends—issues that engendered significant confusion among the investing public—accountants sought also to address the problem of transparency in financial reporting by providing clear guidelines that would aid in adequate disclosure. Other publications such as the *Examination of Financial Statements by Independent Public Accountants* and *A Statement of Accounting Principles* also played a useful role in addressing issues of disclosure in financial reporting. Finally, through certification requirements, an active campaign to rebuild the image of the profession by the American Institute of Accountants, and a revision of auditing procedures in the wake of major scandals, accountants actively attempted to regulate themselves while demonstrating to investors that they were competent professionals and served a role beyond that of a "skilled laborer."[163] By responding to the initiatives of the federal government's legislation with respect to transparency and consistency, and by reacting directly to the criticisms of the investing public itself with respect to competency, the accounting profession embraced the new era of guided self-regulation and sought to reform itself in a way that would regain public confidence. From beginning to end—and from investors to the government to the accounting profession itself—regulation and reform continuously revolved around the three major issues of transparency, consistency, and competency in the decades following the stock market crash of 1929.

In the decades after the crash, the accounting profession progressed through additional phases of self-regulation. The Accounting Principles Board replaced the Committee on Accounting Procedure in 1959 and had a similar goal of reducing diversity of financial reporting practice. In 1973, the Financial Accounting Standards Board—still in existence today—replaced the Accounting Principles Board and is now responsible for establishing accounting standards from within the profession. Each of these entities made progress toward reducing variation in

[163] Mayer-Sommer, 27.

accounting practice, but none of these entities has attained complete uniformity of practice. As historian Thomas King explains, the political environment had a tendency to "hobble the standard-setting process" by slowing the generation of accounting standards and producing compromises that created opportunities for financial manipulation.[164] This was especially apparent in the Enron scandal of the early 2000s, where accountants intentionally used largely-unregulated special purpose entities to manipulate the company's financial statements. These primarily political factors thus created an environment in the decades following the Great Depression that culminated in the massive breakdown of the financial reporting system in the early 2000s. Legislators then created the Sarbanes-Oxley Act to address the ongoing issues of transparency, consistency, and competency that the political and economic environment had perpetuated in the decades leading up to the twenty-first century. As Voltaire famously quipped, "No snowflake in an avalanche ever feels responsible," but each one ultimately contributes to the overall destructive force that ensues.[165] So, too, did the political issues and compromises between 1950 and 2000 build up to the era of scandals in the early twenty-first century, even though no particular incident was directly responsible.

These three areas of focus have not—and likely will not—disappear as the accounting profession works through the first half of the twenty-first century. The "fervor of moral indignation" that swept through the investing public prior to the passage of the Sarbanes-Oxley Act of 2002 prompted an intense outcry for the transparency, consistency, and competency in the accounting profession that are still necessary today.[166] Sarbanes-Oxley has aggressively confronted these concerns over the course of the last decade, and regulators continue to enforce

---

[164] King, 188.

[165] King, 207.

[166] King, 204.

its provisions very strictly. As the profession advances, this most recent act in accounting regulation has greatly intensified the precedent for further regulation going forward. The environment surrounding professional accountancy in 2015, then, is not the result of isolated incidents of fraud in the early 2000s; rather, it is the culmination of decades of responses and reactions that all began with an outcry of the investing public in the aftermath of the stock market crash of 1929.

BIBLIOGRAPHY

Primary Sources

<u>Newspaper Articles</u>

"A Little Auditing, Please." *New York Times*, June 7, 1938.

"Accountants Win in Securities Rule." *New York Times*, April 8, 1934.

"American Can Presents Auditor to Stockholders." *New York Times.* March 8, 1939.

"As to Stock Dividends." *New York Times*, December 10, 1937.

"Bond & Share Income Larger." *New York Times*, June 13, 1929.

"'Certified Accountancy.'" *New York Times*, August 6, 1931.

"Corporations and Publicity.: An Increasing Demand for Fuller Knowledge." *Wall Street Journal*, October 1, 1904.

"Costs Would Be Factor Facing Stockholders in Accounting Change." *New York Times*, January 7, 1939.

"Exchange Rulings." *New York Times*, April 12, 1933.

Geimes, William H. "Securities Act Fight Looming." *Wall Street Journal*, August 7, 1933.

"Highlights of the Stock Exchanges Bill." *New York Times*, February 10, 1934.

"'Innocuous'? 'Evasive'?" *New York Times*, October 26, 1932.

"Inquiring Investor: Intelligent Inquiry is the Public's Safeguard." *New York Times*, August 21, 1930.

"It is not Regulation but Handcuffs for Industry." *Wall Street Journal*, February 16, 1934.

Kilgore, Bernard. "Reading the News of the Day." *New York Times*, February 3, 1933.

---. "Reading the News of the Day." *New York Times*, March 30, 1933.

"Letters to the Editor." *New York Times*, November 4, 1932.

Littleton, A C. "Authentic Information on Corporation Affairs Ought to Be Included in Securities Legislation." *New York Times*, February 25, 1934.

"More Complete Audits Urged: Accountants Institute Asks Exchange Committees Opinion on Submitted Form." *New York Times*, December 25, 1933.

"Nemesis in Office." *New York Times*, October 22, 1932.

"Newspaper Specials: Condensed Exclusive Items of Financial Interest from Metropolitan Newspapers." *New York Times*, July 14, 1930.

"Newspaper Specials: Condensed Exclusive Items of Financial Interest from Metropolitan Newspapers." *New York Times*, May 21, 1932.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*. April 1, 1932.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*, March 12, 1934.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*, March 23, 1931.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*, May 20, 1932.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*, October 4, 1932.

"Newspaper Specials: Condensed Items of Financial Interest from American Newspapers." *New York Times*, September 23, 1932.

"Protest by Accountants." *New York Times*, October 26, 1934.

"Public Interest Requires Further Changes in Bill." *New York Times*, March 24, 1934.

Shipman, Charles. "Inquiring Investor." *New York Times*, September 23, 1933.

"Stock Dividend Rules Outlined." *New York Times*, May 1, 1930.

"Street Gossip: Corporation Loans." *New York Times*, February 27, 1929.

"To Study Accounting Systems." *Wall Street Journal*, September 29, 1931.

"Uniform Accounting Urged for Railroads." *New York Times*, June 5, 1937.

"Wary of SEC, Firm Issues Hedged Estimate—Many Are Advised to Omit Interim Reports." *New York Times*, October 27, 1934.

"Wholesome in Intention." *New York Times*, December 8, 1932.

Other Publications

Accounting Research Bulletin No. 5. 1940. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 6. 1940. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 7. 1940. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 8. 1941. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 9. 1941. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 11. 1941. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 12. 1941. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 13. 1942. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 15. 1942. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 16. 1942. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 17. 1942. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 20. 1943. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

Accounting Research Bulletin No. 22. 1944. http://clio.lib.olemiss.edu/ (accessed August 25, 2015).

American Institute of Accountants. *1930 Year Book of the American Institute of Accountants*, 1930.

Examination of Financial Statements by Independent Public Accountants. New York: American Institute of Accountants, 1936.

Sanders, Thomas Henry, Henry Rand Hatfield, and Underhill Moore. *A Statement of Accounting Principles*. New York: American Institute of Accountants, 1938.

Secondary Sources

Books

Butler, Henry N., and Larry E. Ribstein. *The Sarbanes-Oxley Debacle: What We've Learned; How to Fix It.* Washington, D.C.: AEI Press, 2006.

Chapin, Donald H., and Robert W. Gramling. *The Accounting Profession: Major Issues: Progress and Concerns*. Washington, D.C.: Government Accounting Office, 1996.

Edwards, James Don. *History of Public Accounting in the United States*. Tuscaloosa: University of Alabama Press, 1978.

King, Thomas A. *More Than A Numbers Game: A Brief History of Accounting*. Hoboken: John Wiley & Sons, Inc., 2006.

Knapp, Michael C. *Contemporary Auditing*. Mason, Ohio: Cengage Press, 2011.

Markham, Jerry W. *A Financial History of the United States*. New York: Routledge Press, 2015.

McCraw, Thomas K. *Prophets of Regulation*. Cambridge: Belknap Press, 1984.

Previts, Gary, Peter Walton, and Peter Wolnizer, eds. *A Global History of Accounting, Financial Reporting, and Public Policy*. Bingley: Emerald Group Publishing, 2011.

Rauchway, Eric. *The Great Depression and the New Deal: A Very Short Introduction*. New York: Oxford University Press. 2008.

Seligman, Joel. *The Transformation of Wall Street: A History of the Securities and Exchange Commission and Modern Corporate Finance*. New York: Aspen Publishers, 2003.

Whittington, O. Ray, and Kurt Pany. *Principles of Auditing & Other Assurance Services*. New York: McGraw-Hill, 2014.

Wiesen, Jeremy. *The Securities Act and Independent Auditors: What Did Congress Intend?* New York: AICPA Press, 1978.

Journal Articles

Barr, Andrew. "Accounting Research in the Securities and Exchange Commission." *The Accounting Review* 15, no. 1 (1940): 89-94. http://www.jstor.org/ (accessed May 1, 2015).

Doron, Michael E. "'I Ask the Profession to Stand Still': The Evolution of American Public Accountancy, 1927-1962." *The Accounting Historians Journal* 38, no. 1 (2011): 111-139. http://www.jstor.org/ (accessed May 11, 2015).

Edwards, James Don. "Public Accounting in the United States from 1913 to 1928." *The Business History Review* 30, no. 4 (1956): 74-101. http://www.jstor.org/ (accessed March 1, 2015).

---. "Public Accounting in the United States from 1928 to 1951." *The Business History Review* 30, no. 4 (1956): 444-471. http://www.jstor.org/ (accessed March 1, 2015).

Federer, Peter J. and David A. Zalewski. "Uncertainty as a Propagating Force in the Great Depression." *The Journal of Economic History* 54, no. 4 (1994): 825-849. http://www.jstor.org/ (accessed March 1, 2015).

Graham, John R., Sonali Hazarika, and Krishnamoorthy Narasimhan. "Corporate Governance, Debt, and Investment Policy During the Great Depression." *Management Science* 57, no. 12 (2011): 2083-2100. http://www.jstor.org/ (accessed May 11, 2015).

Heier, Jan R., Maria A. Leach-Lopez, and Marcia A. Leach-Lopez. "Development of Modern Auditing Standards: The Strange Case of Raymond Marien and the Fraud at Interstate Hosiery Mills, 1934-1937." *The Accounting Historians Journal* 37, no. 2 (2010): 67-93. http://www.jstor.org/ (accessed May 12, 2015).

Mayer-Sommer, Alan. "Public Accounting in 1929." *The Accounting Historians Journal* 7, no. 2 (1980): 23-44. http://www.jstor.org/ (accessed March 1, 2015).

Mitchener, Kris James. "Bank Supervision, Regulation, and Instability During the Great Depression." *The Journal of Economic History* 65, no. 1 (2005): 152-185.

Nouri, Hossein and Danielle Lombardi. "Auditors' Independence: An Analysis of Montgomery's Auditing Textbooks in the 20th Century." *Accounting Historians Journal* 36, no. 1 (2009): 81-112. http://www.jstor.org/ (accessed March 1, 2015).

Peretz, Paul, and Jean Reith Schroedel. "Financial Regulation in the United States: Lessons from History." *Public Administration Review* 69, no. 4 (2009): 603-612. http://www.jstor.org/ (accessed May 12, 2015).

Vance, Lawrence L. "The Road to Reform of Accounting Principles." *The Accounting Review* 44, no. 4 (1969): 692-703. http://www.jstor.org/ (accessed May 11, 2015).

White, Allen L. "Why We Need Global Standards for Corporate Disclosure." *Law and Contemporary Problems* 69, no. 3 (2006): 167-186. http://www.jstor.org/ (accessed May 11, 2015).

Wicker, Elmus. "A Reconsideration of the Causes of the Banking Panic of 1930." *The Journal of Economic History* 40, no. 3 (1980): 571-583. http://www.jstor.org/ (accessed March 1, 2015).

Wootton, Charles W., and Carel M. Wolk. "The Development of the 'Big Eight' Accounting Firms in the United States, 1900 to 1990." *The Accounting Historians Journal* 19, no. 1 (1992): 1-27. http://www.jstor.org/ (accessed May 12, 2015).

Zeff, Stephen A. "How the U.S. Accounting Profession Got Where It Is Today." *Accounting Horizons* 17, no. 3 (2003): 189-205. http://www.ruf.rice.edu/ (accessed December 2, 2015).

Government Publications

U.S. Securities and Exchange Commission. *Registration Under the Securities Act of 1933*. September 2, 2011. http://www.sec.gov/answers/regis33.htm (accessed November 3, 2015).