

A ‘New Deal’ for the profession

Regulatory initiatives, changing knowledge conceptions and the Committee on Accounting Procedure

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Abstract

Purpose – The purpose of this paper is to analyze how “New Deal” regulatory initiatives, primarily the Securities Acts and the Securities and Exchange Commission (SEC), changed US auditors’ professional knowledge conception, culminating in the 1938 expansion of the Committee on Accounting Procedure (CAP), the first US body to set accounting principles.

Design/methodology/approach – The paper combines Halliday’s (1985) knowledge mandates with Hancher and Moran’s (1989) regulatory space to attain a theory-based understanding of auditors’ changing knowledge conceptions amid regulatory pressure. It draws on a range of primary and secondary sources to examine the period from 1929 to 1938.

Findings – Following the stock market crash, the newly created SEC aimed to engage auditors as a means to regulate companies’ accounting practices based on a set of codified principles. While entailing increased status, this new role conflicted with the auditors’ knowledge conception, which was based on professional judgment and personal integrity. Pressure from the SEC and academics eventually made auditors agree to a codification of their professional knowledge and create the CAP as a cooperative regulatory solution.

Originality/value – The paper explores the role of auditors’ knowledge conceptions in the emergence of today’s standard setting. It is suggested that auditors’ incomplete control of their professional knowledge made standard setting a form of co-regulation, located between the actors occupying the regulatory space of accounting.

Keywords Accounting profession, Standard setting, Committee on Accounting Procedure, Knowledge mandates, Regulatory space

Paper type Research paper

1. Introduction

The history of the accounting profession has received much attention from critical accounting research, which has studied auditors’ largely successful attempts to obtain economic advantages and gain social status[1]. Asserting that auditors pursue private objectives under a public interest argument (Lee, 1995; Baker, 2005), researchers have examined professional activities, such as auditors’ market closure (Walker and Shackleton, 1998) or their involvement in audit regulation (Shapiro and Matson, 2008; Hazgui and Gendron, 2015). The sociology of professions also emphasizes the role of knowledge in professionalization projects, as cognitive exclusiveness is considered essential to control a market (Larson, 1977; MacDonald, 1995). Since professional knowledge requires judgment, it yields power to professionals, who are seen as exercising skills that cannot be routinized or inspected (Larson, 1977; MacDonald, 1995). Yet limited attention has been given to the ways in which auditors control their knowledge, perhaps because this knowledge is considered elusive (Hines, 1989). In auditing, knowledge control



may refer to the training process and professional credentials (Richardson, 1988), but also to how and by whom accounting knowledge is codified and defined. An important way to control this knowledge might therefore be to preside over standard setting.

This paper analyzes the US auditors’ attempt to take control of their knowledge, in particular how this attempt emerged out of heterogeneous regulatory conceptions of accounting. Going back to the beginnings of standard setting, the study focuses on the period between the 1929 stock market crash and the 1938 expansion of the Committee on Accounting Procedure (CAP), being the first US body to set accounting principles. Particular attention is given to regulatory interactions between auditors, the Securities and Exchange Commission (SEC), the New York Stock Exchange (NYSE) and accounting academics. To analyze the actors’ regulatory positions on the codification of accounting knowledge, their changing power relations and coalition-building, the study combines Halliday’s (1985) knowledge mandates to analyze the structural dimensions of a profession’s influence with Hancher and Moran’s (1989) regulatory space to assess the dynamic patterns of how regulation is shaped.

It is argued that the CAP emerged out of two partially incongruent regulatory positions, namely the regulatory scheme enshrined in the Securities Acts and acted out by the SEC, and auditors’ conception of their professional knowledge. First, the SEC’s focus was on companies as their main objects of regulation and the Commission aimed to employ private sector means to achieve its regulatory end of bringing order to the corporate sector. Such “participatory regulation” (McCraw, 1984) relied on professional groups, such as auditors, to become regulatory agents and ensure companies’ use of appropriate accounting procedures. Second, auditors, who at the time were still a heterogeneous group divided between two professional associations, did not play a significant role prior to the stock market crash and were often considered under the influence of corporate management. Thus far, they understood their knowledge as derived from professional judgment and personal integrity. Such knowledge was gained through experience and by virtue, and would be made redundant by accounting regulation. This conception soon conflicted with the regulatory information gathered by the SEC that showed the diversity of accounting practices and demonstrated the need for codified accounting principles. In the face of mounting pressure, also from increasingly vocal academics, auditors first increased their legitimacy by organizing in one professional association. They also accepted, albeit reluctantly, the need to codify their knowledge in a set of principles to guide their professional judgment. Auditors thus became regulatory agents, which considerably increased their status and potentially emancipated them from companies. Yet their overall reluctance to change led to an incomplete control of their professional knowledge, as academics and other regulatory actors had co-opted the process. The expanded CAP thus became a cooperative solution, or a “hybrid regulatory pattern” (Hazgui and Gendron, 2015), located between the parties occupying the regulatory space.

The paper seeks to make two contributions: first, while the sociology of professions emphasizes the need to control professional knowledge (Larson, 1977; MacDonald, 1995), little is known about knowledge conceptions in accounting (Richardson, 1988; Hines, 1989) and the ways in which auditors have attempted to make a knowledge claim. The paper argues that auditors’ understanding of their knowledge as primarily based on judgment and integrity was an essential and perhaps decisive factor in the regulatory debates. Initially, this claim gave auditors both moral and technical authority, but soon clashed with the SEC’s views. Outside pressure from the regulator and vocal academics made auditors shift their knowledge conception toward a more technical understanding. Further studies of auditors’ knowledge claims are invited to explore this as yet neglected aspect of the sociology of professions more fully.

Second, the study adds to recent work on the regulatory context of securities regulation and the ideological foundations of the US accounting profession (Doron, 2011, 2015, 2016).

It connects what emerged as standard setting to the earlier regulatory conceptions of accounting as a means of corporate control (Radcliffe *et al.*, 2017), and spells out the SEC's regulatory view of auditors as "free labor" to pursue its goals, which has also been documented elsewhere (Larsson, 2005). In light of auditors' incomplete control of their knowledge, the study suggests that today's standard setting is located between the actors that participated in the regulatory debates. Attempts to theorize standard setting may need to devote more attention to actors' historical stakes in the process, as criticism of auditors' excessive influence (Botzem, 2014) may misread the history of standard setting. Ample opportunities exist for accounting history researchers to study the changing positions of regulatory actors over time, as auditors have partially retreated from the process (Zeff, 1986), companies' lobbying activities have increased (Zeff, 2002), and standard setters' rhetoric has changed (Young, 2014).

The remainder of the paper is organized as follows: the next section explains the theoretical framework based on Halliday's (1985) knowledge mandates and Hancher and Moran's (1989) regulatory space. Section 3 details the study's research methods, before Section 4 maps out the regulatory space of accounting. The historical narrative follows in Section 5, while Section 6 discusses the narrative and concludes the paper.

2. Knowledge mandates in the regulatory space

A knowledge mandate views a profession's knowledge as the key source of its influence on the state, being exerted "in virtue of the substance, form, transmission, efficacy, mobilization, objects and legitimacy of its cognitive core" (Halliday, 1985, p. 422). While a knowledge mandate also explains how influence is wielded, it does not fully recognize the dynamics of regulatory debates (Joyce, 2014). It is argued here that Halliday's (1985) structural dimensions of influence can be used and drawn upon by a profession to exert power in a regulatory space (Hancher and Moran, 1989). Viewing regulation as any kind of rule-making, the regulatory space focuses on the actors participating in the regulatory process as well as their roles, positions, and interactions that are constantly negotiated. Actors hold fragmented resources that lend them informal authority (Scott, 2001), and the relations between them may affect the outcomes of debates, ranging from the regulator overcoming resistance from regulatees (Canning and O'Dwyer, 2013) to actors developing a "form of allegiance" (Malsch and Gendron, 2011) or engaging in "co-regulation" (Hazgui and Gendron, 2015). In turn, it is argued that the relationships and interactions between actors in the space are organized by Halliday's (1985) knowledge mandates, which are a function of a profession's standing on the following four dimensions.

Epistemological basis

A profession's cognitive core defines the kind of knowledge on which its authority rests. If challenged, such as by looming regulation, a profession tends to retreat to how its knowledge is created by invoking its cognitive foundations. Halliday (1985, p. 425) distinguishes between scientific and normative professions, with the former deriving knowledge "from observation and experimental inquiry." Normative professions, such as auditing, are based on value judgments, that is, assertions of what should be. This prescriptive core empowers them to engage readily in regulatory debates. Since they are the main users of their knowledge, they also hold the original and most powerful claim to this knowledge. Yet their cognitive base is not secure and enables other actors to join in on discourses and engage in policy debates. Normative professions thus need to constantly defend their knowledge to maintain authority and their claim to be useful to society (Halliday, 1985; Joyce, 2014).

In the regulatory space, knowledge becomes contested, as tensions emerge around what it means and whether rules should be found for its application. Richardson (1988, p. 393) concludes that auditors have derived much of their privilege from "codification of practices in politically sensitive areas." Accounting knowledge refers to the preparation and audit of

financial statements, but also to the content and meaning of rules that regulate financial statements. Auditors may be most versed in the practical application of these rules, whereas other groups, such as academics, may be better equipped to consider the fundamental principles underlying financial statements. In some countries, this has led to a division of labor between these groups (Evans and Honold, 2007). Such knowledge conceptions are now taken for granted, but had yet to emerge in the period of investigation. The vagueness of accounting knowledge (Hines, 1989) made this question a delicate one, as it had implications for auditors' claim to be a profession. Applying judgment, perhaps within a framework of broad accounting principles, would be conducive to this claim, whereas a detailed set of rules might restrict judgment and a professional claim. Regulation became both a solution and a problem, with regulatory actors acknowledging some need for it, but fearing that it would place too tight boundaries on the exercise of judgment.

Form of authority

In making itself heard, a profession can exert two types of authority: while technical authority is based on the profession's core knowledge, moral authority relates to other areas, such as ethics (Halliday, 1985). Exerting moral authority makes a profession's influence far-reaching, but it depends on the ability to blur the distinction between the forms of authority. Dressing moral issues as technical ones, power exerted in one area can be transferred to another. The more easily the issues blur, the easier it is for professions to exert political influence “under the pretext of technical insight” (Halliday, 1985, p. 430). This blurring is often sought actively and may even become unclear for the profession itself.

Institutional sphere

A profession's activities can reach into two types of institutional spheres. The profession's primary sphere is where it has “a legitimate and particular interest” (Halliday, 1985, p. 431). In its secondary sphere, the profession has less legitimacy and its practice is restricted, as it trespasses on another profession's primary sphere. The further away a profession acts from its primary sphere and the less it is able to blur the lines between expert and moral authority, the lower its legitimacy and influence.

The forms of authority and the institutional spheres resonate well with the set of activities that are bracketed in the regulatory space (MacDonald and Richardson, 2004). When engaging in rule-making, the regulator must pay heed to actors' existing discourses, and base its activities on these positions or alter the discourse in a particular direction. As large organizations are not only loci of power and holders of expertise, but also subjects of regulation (Hancher and Moran, 1989), powerful representatives of these organizations access the space and aim to influence the debates. As their authority becomes decisive in the regulatory negotiations, it will depend on these professionals' ability to use, or dress, input as technical to invoke authority. Given the elusiveness of accounting knowledge (Hines, 1989), auditors likely aim to blur the boundaries between technical and normative inputs to increase their influence. The question of the form of authority is closely linked to the kind of knowledge a profession aims to claim. As the distinction between these forms also blurs for auditors themselves, the regulatory boundaries surrounding judgment curtail their technical advice and have moral ramifications.

Regulation is a constant process of negotiation between the regulator and the regulatees, with the meaning of legislation, the boundaries of the space and the legitimacy of the regulator being key issues (MacDonald and Richardson, 2004; Canning and O'Dwyer, 2013; Hazgui and Gendron, 2015). An institutional sphere may be understood as flowing from the activities of a profession and defining a set of activities for which rules are to be found. These activities define the sphere, where the profession is the most central actor and where it is most embedded in the prevailing practices (Greenwood and Suddaby, 2006; Bucher *et al.*, 2016).

Peripheral actors speak with less authority and may naturally look to this profession to become active and exercise influence, be it in the form of expert or moral authority (Joyce, 2014). Conversely, peripheral actors may join the regulatory debates, so as to undermine the profession and occupy a central position themselves.

Organization of collective action

To reap the benefits of its influence on the state, a profession needs to organize. Halliday (1985) distinguishes three organizational properties: integration describes the representation of collective interests in a national association, while a profession's homogeneity affects its ability to make decisions. As normative professions often engage in debates where strong beliefs are held, homogeneity becomes decisive in successfully launching collective actions. A third property relates to the profession's network and its ability to create coalitions with potential allies. Organizational features are the key determinants of regulatory actors' positions and changing influence in the space, where coalitions are constantly sought and shaped. Being able to coordinate actions will thus translate into a more powerful position in the space.

3. Research methods

This study began as a desk-based project to understand the role of US auditors in the emergence of standard setting as well as the fledgling profession's claim to an indeterminate knowledge. As a starting point, secondary sources were reviewed to gain a thorough understanding of events in the period of investigation (Carey, 1969; Zeff, 1972; Previts and Merino, 1998; Seligman, 2003). Subsequently, a conscious and substantial effort was made to go back to the primary sources and access the available documentary data and archival material for the time period of interest. This included the online archives of the SEC Historical Society and the AICPA's collection at the University of Mississippi, which hosts the profession's yearbooks, monthly bulletins, as well as other professional publications. This set of sources was augmented by articles in the *Journal of Accountancy* and *The Accounting Review*, as well as secondary material on the histories of the audit firms and biographies of key professionals.

Data analysis went through a number of iterations to analyze the literal and structural meaning of the evidence and to bring out the theoretical contributions (Shapiro and Matson, 2008; Canning and O'Dwyer, 2013). First, a solid understanding of the time period was a key objective with an eye not only to grasp the major events of the period, but also to document these events via an analysis of the available and accessible material as outlined above. A second analytical iteration comprised a revisiting of the material to find the theoretical lens most useful to understand and analyze the material for the purpose of this study. Third, following the "choice" of an adequate theory, the evidence was reviewed again to augment and solidify the analysis, and strengthen the insights on the construction of a knowledge mandate in the regulatory space.

The following narrative first maps out the regulatory space prior to the period of investigation to explore the positions of the main actors and conceptions of accounting that were considered, albeit vaguely, in the space. It is argued that auditors had not yet achieved professional status in Halliday's (1985) terms, but were somewhat peripheral actors, as the space was dominated by companies and stock exchanges. The 1929 stock market crash disrupted this balance of power and auditors saw an opportunity to gain status and initiated a claim based on their knowledge.

4. The regulatory space of accounting: key actors and regulatory conceptions

In the 1920s, auditors were lacking on all three of Halliday's (1985) properties of integration, homogeneity, and networks. For one, they were dispersed among two professional organizations.

The American Institute of Accountants (AIA) was established in 1887 by emigrants from the UK. In line with the British traditions, it favored an apprenticeship system to becoming an auditor and considered Institute’s membership as superior to the CPA (Doron, 2011). Since the CPA was conferred by the states, it was viewed only as a license to practice and the AIA members did not need to be CPAs. In response to such elitist thinking, the American Society of Certified Public Accountants (ASCPA) was founded in 1921 “to protect and foster the integrity of the CPA as granted by states at any cost [and] to provide American Certified Public Accountants with an organization truly American and founded on the democratic principles upon which our republic has been reared” (Certified Public Accountant, 1922, p. 5). ASCPA membership was conditional on carrying a CPA and the society attracted those auditors “who thought the AIA too ‘Eastern’ and too closely allied with big-city bankers” (Miranti, 1990, p. 123). Yet, in the 1920s, AIA elitism was slowly undermined, as the Institute itself was increasingly made up of non-British auditors (Nissley, 1928). This was also reflected in membership numbers: in 1930, the ASCPA had 2,619 members and was larger than the AIA with 2,196 members, compared to more than 13,000 practitioners in the country (Springer, 1930, p. 281; Carey, 1969, p. 349). Adding to this heterogeneity, each state had its own society of certified public accountants, with the one in New York being the most influential with 1,580 members (Certified Public Accountant, 1931, p. 191).

Leadership and political influence by the professional organizations remained weak in the 1920s and also did not come immediately after the stock market crash (Doron, 2011). Rather, it came in the person of powerful individuals, primarily George O. May, who led Price, Waterhouse & Co. to become the leading audit firm in the USA. In 1926, he resigned from his position as a Managing Partner to devote more time to professional affairs, becoming auditors’ most vocal spokesperson in the next decade. Besides Price Waterhouse, several other audit firms had established a national presence in the market, but had done so to a varying degree. Although ten audit firms conducted the large majority of audits in 1927 (Richardson, 1927), it was only auditors’ increasing involvement with audits of companies with securities traded on stock exchanges that helped them establish auditing as a profession. The Securities Acts were significant stimuli for this expansion (McCraw, 1984), providing the large firms with more powerful positions in the regulatory space and offering auditors the opportunity to forge powerful coalitions with other actors. In the early 1930s, however, auditors were constituted only loosely and held together mainly by some vocal individuals.

Another actor that turned out to be significant was accounting academics, who, like auditors, were so far suffering from a lack of recognition. In 1916, a small group of academics organized the American Association of University Instructors in Accounting (AAUIA) to exchange and promote ideas of teaching accounting (Zeff, 1966). From the beginning, there was a degree of overlap between professors and practitioners, which, however, did not translate into uniformly positive attitudes by auditors toward the academic association. In 1919, the AAUIA suggested to the AIA that academics be allowed to full members of the Institute, which was promptly rebuffed (Zeff, 1966). Only when the ASCPA entered the arena in 1921 were academics seen more positively and those with a CPA were accepted as full members into the rival organization. When, in the mid-1920s, increasing numbers of auditors were university graduates, higher education began to be seen as important (Nissley, 1928; Carey, 1969). The graduates often came from universities in the Midwest, whose accounting programs grew considerably at the time. While academics generally began to embrace research activities and association activities broadened, those located at Midwestern institutions also became active in professional affairs. They also aimed to distance themselves from their colleagues at Eastern, Ivy League institutions, who tended to be associated with the “elitist” AIA (Miranti, 1990), implying a similar divide among academics as in auditing.

In turn, companies had thus far considered their corporate affairs as “private and privileged” and feared that “valuable secrets might be revealed to competitors” (McCraw, 1984, p. 166). As managers invoked a right to corporate secrecy, they applied capricious accounting practices. This was enabled by a concurrent lack of auditing: A 1927 survey found that only 892 of about 15,000 industrial companies had been audited (Richardson, 1927)[2]. If auditors were engaged, they were considered to be influenced by management (McCraw, 1984), implying that “sheer independent audit would be no better than management audit as we have it at the present time” (Ripley, 1927, p. 134). After 1929, as will be detailed below, companies did not have much regulatory clout and were largely absent from the regulatory space. Instead, they would become the objects of government regulation, which aimed to engage professional groups, among them auditors, as part of the regulatory framework. As a result, and unlike a contemporary conjecture might suggest (Botzem, 2014), auditors were not representing companies by proxy in the space, but were to become regulatory agents, which conflicted somewhat with the previous views of them being in the grip of corporate management.

Absent auditing, it had been mostly investment banking houses that had insights in companies’ accounting, and investors and the public relied on their business judgment (McCraw, 1984). Yet these intermediaries were slowly replaced by other actors who had little regard for transparency, but subscribed largely to market forces in their speculative activities. These players were mostly active in the over-the-counter market, where thousands of independent brokers and dealers traded absent any regulation (McCraw, 1984). What emerged was a large information asymmetry between companies, who withheld accounting information, and retail investors, who relied on financial intermediaries that had little interest in reducing this asymmetry. The only regulatory force was the stock exchanges, which varied widely in their requirements and their concern for disclosure. Even if a stock exchange found stricter requirements necessary, its hands were tied to “inserting them in new agreements for the listing of new issues, but [it] was not in a position to rewrite its existing agreements” (Sanders, 1937, p. 193). Edward H. H. Simmons, then President of the NYSE, being the most influential exchange, asserted that the NYSE could not verify “the accuracy of the statements made to it in the listing application” and that it was “by no means equipped to undertake any policy of controlling American corporate practice” (cited in Parrish, 1970, p. 39). His successor Richard Whitney, who “symbolized the aristocratic tone of the exchange oligarchy,” was widely cited as telling Senate staff in 1933: “The Exchange is a perfect institution” (McCraw, 1984, pp. 193-194). This attitude also materialized in the NYSE’s disregard for auditors, as shown by Whitney’s rejection of George May’s offer to cooperate following criticism in the 1920s of corporate accounting practices (Carey, 1969; Zeff, 1972).

So far, the government’s influence in accounting had been fairly limited. What existed were so-called “blue-sky laws,” which, beginning with Kansas in 1911, most states had issued to prevent fraud in the securities trade. It turned out quickly though that these state securities laws could be bypassed simply “by making offerings across state lines through the mails” (Seligman, 2003, p. 45). The only institution that played a role was the Federal Trade Commission (FTC). Installed in 1914 to regulate interstate trade, it was set up in the spirit of the Progressive movement that saw the break-up of Standard Oil, American Tobacco, and DuPont Chemical. Such anti-trust activities to re-instate competition were expressive of the time’s “anti-bigness ethic” that also stood behind the FTC (McCraw, 1984, p. 82). Regulatory conceptions of accounting mirrored the progressive thought, in that accounting was seen as part of a system of corporate control to ensure competition and oversight (Clark, 1926; Radcliffe *et al.*, 2017). Such a system of uniform accounting methods was used in the strictly regulated railway sector (Adams, 1918), but was at times also considered for other industries and on a national level (Miranti, 1990). In 1917, FTC Chairman Edwin Hurley approached the AIA to formulate a set of accounting rules and set

up a national register of auditors (Carey, 1969). The Institute avoided regulatory intervention by contributing to a Federal Reserve Bulletin titled “Uniform Accounts.” Since the bulletin covered mainly audit procedures, the auditors “may have taken advantage of some confusion in Mr. Hurley’s mind as to the distinction between uniform accounting and standard audit requirements” (Carey, 1969, p. 133). This conception of accounting as a means of corporate control was carried into the 1920s (Clark, 1926) and also loomed after the stock market crash, particularly in light of Roosevelt’s other New Deal reforms and the 1933 Securities Act placing oversight responsibility in the FTC. If carried out, it would entail detailed regulation in the form of standardized industry accounts. Leaving little room for interpretation, uniform accounting systems might, if anything, require a form of compliance verification, which contrasted with auditors’ understanding of their work, particularly as to their use of professional judgment.

5. Constructing a knowledge mandate in the regulatory space

Auditors’ entry into the regulatory space, 1929-1933

Between the 1929 stock market crash and 1932, stocks listed on the NYSE lost more than 80 percent in value (Seligman, 2003). Bankers and companies were blamed alike for misleading investors and, as it was widely claimed, “defraud the public.” Many companies had not disclosed financial statements or had used accounting to present themselves in the best light, such as by recognizing profit on the sale of securities to a subsidiary so as to pay dividends (Ripley, 1927). Not only companies came under pressure, but also stock exchanges as the arbiters of accounting practices and overseers of securities markets in the spirit of self-regulation. As Sobel (1968, p. 158) diagnoses: “The 1929 crash changed all this. Unable to cope with the depression, finance capitalism conceded that it lacked powers formerly ascribed to the private sector of the economy. Leadership would have to come from another quarter.”

A government investigation was launched in April 1932. Lasting until June 1934, the hearings, led by Ferdinand Pecora, focused on the corporate misbehavior prior to the stock market crash, and culminated in the Securities Acts. While overall little attention was given to accounting (Miranti, 1990), the Pecora investigation examined some of the most prominent bankruptcies of the time, among them the Swedish “match king” Ivar Kreuger and Samuel Insull’s public utility empire. In both cases, auditors played a vital role: Ernst & Ernst had revealed the Kreuger fraud during an audit of a subsidiary (Stock Exchange Practices, 1933), and Price, Waterhouse & Co. investigated this fraud. In turn, Arthur Andersen was engaged at the Insull companies, which was “of momentous consequence to the firm” (Arthur Andersen & Co., 1963, p. 10). At the hearings, auditors were praised for their involvement in investigating the frauds. A.D. Berning of Ernst & Ernst and George O. May, who participated in the hearings, fostered the impression that auditing was indeed a possible solution to dubious accounting practices.

In turn, the Kreuger fraud was considered impossible “had it not been either for the carelessness, indifference or connivance” of the NYSE (cited in Flesher and Flesher, 1986, p. 426). The exchange quickly required audits of listing applicants and planned to extend this requirement to all listed companies, making auditing a private sector regulatory mechanism. Indeed, by 1933, about 85 percent of listed companies’ financial statements were audited (Hearings on S. 875, 1933, p. 56). This emphasis on auditing demanded some agreement on accounting principles, as suggested by Frank Altschul, the Chairman of the NYSE’s Committee on Stock List:

[W]e have begun to wonder whether an independent audited statement, which may mean so much and may mean so little, would not in itself become ultimately a matter that would involve further deception of the public. We have been having, therefore, a series of meetings and conferences with

accountants with a view to seeing whether as long as the public is going to be asked to place so much reliance on the statements of independent auditors, if we cannot get some agreements in cooperation with the accountants in regard to some of the general governing principles of accounting and in regard to accounting practice (Stock Exchange Practices, 1933, p. 1358).

Altschul submitted to the Senate Committee a preliminary report that was based on a letter from George May. The report named five widely accepted principles of accounting, apart from which “it is relatively unimportant to the investor what precise rules or conventions are adopted by a corporation in reporting its earnings if he knows what method is being followed and is assured that it is followed consistently from year to year” (Stock Exchange Practices, 1933, p. 1361). Building on this correspondence with the NYSE, the AIA went on to publish *Audits of Corporate Accounts* (1934), which also included a sixth recommendation. These “six rules or principles” were approved at the AIA’s 1934 annual meeting, becoming binding for all Institute members.

A first step was thus made toward the codification of accounting knowledge and that it featured in the Senate investigation showed its significance, but also its regulatory urgency. Yet, instead of a decisive move by auditors to define their knowledge, the principles represented a minimum consensus of well-established practice. They were “so generally accepted that they should be followed by all listed companies – certainly, that any departure therefrom should be brought expressly to the attention of shareholders and the Exchange” (*Audits of Corporate Accounts*, 1934, p. 27). By endorsing and institutionalizing standard procedures, the pamphlet was merely a regulatory expedient that served as an epistemological argument to address the concerns of other actors, enabling auditors to frame their work as a remedy to fraud and position themselves in the regulatory space. Yet the pamphlet’s position was clear: broad principles were preferred over detailed rules and companies should be free to choose among accepted principles of accounting those that fitted best their financial statements. In hindsight, May described his 1932 letter as “the opening gun in the battle” of uniformity vs flexibility (Grady, 1962, p. 78), suggesting that it played a larger role than intended. That is, auditors had meant to use their cognitive core only to enter the regulatory space. Prescriptive statements conflicted with their epistemological basis.

The regulatory conceptions of the Securities Acts, 1933-1934

As the Pecora investigation shed light on corporate misbehavior, auditors portrayed their work as a private sector solution to improve accounting and disclosure practices. Emerging as a technical authority in their primary institutional sphere, auditors did not expect that they might also be at the receiving end of regulation. The first wave of President Roosevelt’s “New Deal” included an array of reforms, of which “Few legislators understood fully the details of any two pieces of legislation” (Parrish, 1970, p. 112). In May 1933, the Securities Act was enacted to prevent corporate excesses and frauds, requiring detailed disclosure of information on securities offered for public sale. It placed oversight responsibility in the FTC, which, in light of its prior role in the Progressive era and Roosevelt’s further activist program, might have signaled deeper industrial control and an anti-trust focus as part of its mandate. For accounting, it could have brought strict regulatory intervention and, in fact, its short period of administration was criticized heavily for these reasons as “somewhat abortive” (Sanders, 1937, p. 209). The Act itself was “the quintessential sunshine law,” ensuring only that appropriate information was provided (McCraw 1984, p. 172). This disclosure approach was backed by various enforcement mechanisms, such as mandatory financial statement audits and wide-ranging liability for the parties involved in producing registration statements.

The Act’s disclosure focus was justified by two reasons, one relating to its regulatory conception and one being practical. First, the principal draftsmen of the Securities Act – a

group surrounding Harvard Law Professor Felix Frankfurter – had different regulatory views than those proclaimed in the Progressive era and on which the FTC was founded. They were as skeptical of a far-reaching government as they were of large organizations, so were unwilling “to see one power center extinguish all others” (Parrish, 1970, p. 61). Instead, the group preferred a model of “participatory regulation,” in which private structures and incentives would be exploited to public ends and new structures created only where needed (McCraw, 1984). Such a common purpose of regulator and regulatees implied that rules and regulations would arise out of dialogue, thereby increasing participation and commitment to the rules so crafted, rather than relying on decrees and litigation (Parrish, 1970). This conception meant that “the integrity of the accountant and the soundness of his method are the greatest single safeguard to the public investor and to the market in general. But rules of accounting are not as yet fully recognized rules of law in this field; though it is obvious that the development of the law of corporation finance makes almost mandatory the legal sanction of good accounting practice” (Berle and Means, 1933, p. 310). Accounting would become a regulatory instrument that needed to be developed more fully, but was an important piece in the Securities Act’s regulatory conception. The second, practical reason for the disclosure focus was that an interventionist approach required extensive resources, which “Congress was unlikely to authorize” and government agencies “would have trouble putting to good use” (McCraw, 1984, p. 190). The extent of the bureaucracy needed to administer this alternative approach thus prevented “autocratic and arbitrary authority” (Parrish, 1970, p. 184), in turn increasing the role of professional groups in the developing regulatory framework.

In 1934, Congress enacted the Securities Exchange Act to extend regulation to securities traded on stock exchanges. The Act created the SEC, which began operations in July 1934, taking over the administration of the Securities Act from the FTC. As Parrish (1970) details, the Securities Exchange Act also had been subject to intense bickering, which can be summarized as a debate about the extent of intervention in the market. The creation of the SEC was also discussed intensely, both for economic reasons and in the Progressive spirit, which preferred the FTC’s mandate and an interventionist approach. Yet the SEC proponents prevailed and the Commission was given broad powers over all aspects of securities trading, including rules for the preparation of financial statements. These extensive powers brought the SEC as a new powerful actor into the regulatory space of accounting.

The SEC had wide discretion as to enacting its mandate, which included any additional rules and further legislation (McCraw, 1982). That is, the regulatory conception outlined above needed to be acted upon and implemented by the Commission, which consisted of five individuals. The first SEC Chairman, Joseph P. Kennedy, had made a fortune in the stock market and was connected closely to the SEC’s regulatees. His choice as Chairman was by some considered as “absolutely, totally incredible” (Seligman, 2003, p. 103). Yet he was also someone who “knew how to make things happen” and his appointment was a signal that Roosevelt “wanted action in the securities markets” (McCraw, 1984, p. 183). The remaining Commission was then an “exceptionally strong appointment” (McCraw, 1984, p. 182): James M. Landis, the SEC’s second Chairman, had been part of the Frankfurter group. George C. Mathews had been involved with utility regulation and brought with him expertise in accounting. Robert E. Healy had been the FTC’s General Counsel, where he had extensively studied public utility frauds, including these companies’ accounting practices. Finally, Ferdinand Pecora had led the investigation into stock markets. On accounting, the Commissioners’ attitudes were shaped by their experience with and exposure to practice. Landis and Mathews generally supported auditors’ self-regulation, whereas Healy and Pecora wanted a more activist role, with Chairman Kennedy showing no particular interest in accounting (Seligman, 2003). These positions were tested in October 1934, when the Commission decided by a vote of 3-2

that the Northern States Power Company could continue its disputable practice of writing up accounts. The SEC required only a footnote stating that “the results shown in the balance sheet would not have been the same if another accounting procedure had been followed” and a summary of the alternative results (Seligman, 2003, p. 117).

Although the 1929 crash had disrupted routines significantly (Hancher and Moran, 1989), the SEC initially preferred little or no involvement in accounting. However, awareness of accounting had been low during the passing of the Securities Acts (Doron, 2016), and the SEC consisted primarily of “lawyers or economists, with less than a perfect understanding of accounting and auditing” (Carey, 1979, p. 35). This lacking awareness might explain the SEC’s early reluctance to take action in an area perceived of lower importance, especially since the Securities Acts were meant to regulate companies and stock exchanges. Yet the commitment to noninterference was feeble, because a deeper understanding of accounting might change the Commissioners’ views. It also relied on the Commissionship, which had so far “escaped the litigiousness and procedural obsession associated with lawyer control” (McCraw, 1982, p. 362). Any change among the Commissioners could result in a more interventionist approach.

Auditors’ first knowledge claim, 1934-1936

The Securities Acts’ potential encroachment on accounting came as a surprise to auditors, who had not developed a strategy to deal with this threat of intervention or the far-reaching liability provisions (Carey, 1969; Miranti, 1990). Even the audit requirement included in the Securities Act was introduced only as an afterthought by taking over British company law (Doron, 2015). Striving to install a link with the SEC, the AIA appointed a Special Committee on Cooperation with the SEC. Its main focus was to limit the Commission’s regulatory attention to the form and content of financial statements. The committee was intended as a short-term panel, appointed only “for the short further period necessary to finish this work” (American Institute of Accountants (AIA), 1934, p. 275). Similarly, a Joint Committee (1934) between the AIA and the ASCPA was appointed to feed auditors’ views to the SEC that financial statements should be “prepared in the form and detail which the management and the independent accountants believe fairly present the financial condition and operating results of the corporation” (p. 2). Relating this view to the SEC involved “a big job of education” (Carey, 1979, p. 35), and auditors assumed such an educational, but otherwise minimalist role in the regulatory space, arguing not that accounting regulation was a private sector task, but that it was not a regulatory issue at all. This position was based on their understanding of auditing as a craft skill that relied on expertise and judgment, as expressed by a committee under the chairmanship of George May:

Since principles of accounting cannot be arrived at by pure reasoning, but must find their justification in practical wisdom, the committee believes that the Institute should proceed with caution in selecting from the methods more or less commonly employed those which should be accorded the standing of principles or accepted rules of accounting (AIA, 1934, p. 276).

In that spirit, auditors successfully shifted the regulatory discourse from detailed accounting requirements to financial statement formats. When issuing the registration forms, Commissioner Mathews (1935, p. 4) confirmed that the SEC had “carefully avoided requiring uniformity of accounting.” Auditors’ input was relied on as expert advice, not only because other actors or positions were absent, but also because the SEC did not have any regulatory incentive to pursue an alternative path. Commissioner Landis (1933) admitted that accounting represented a field of “heathenish mystery” to him, yet wondering:

whether you, just like the members of my profession [that is, law], do not tend to make more mysterious your own knowledge so as to widen the gulf that separates you and us from the ordinary unsuspecting laymen.

Soon, it became clear to the SEC that auditors were “a linchpin of the entire regulatory scheme” (McCraw, 1982, p. 349), and Commissioner Landis began to reach out to auditors to present his “appealing plan for ‘self-regulation’” (McCraw, 1982, p. 352). The SEC hoped to encourage their cooperation, namely to put forward accounting rules for the SEC to enforce compliance with. Although Landis “showed no particular affection for accountants,” he recognized their shared interests in that auditors wanted to escape the grip of corporate managers, who thought little of auditing and transparent financial reporting (McCraw, 1984, p. 190). Pointing to the benefits of cooperation, Landis (1935) argued: “We convinced you and you convinced us that we could work together earnestly, harmoniously and effectively.” These conciliatory messages led auditors to believe that they had convinced the SEC that their professional judgment was sufficient to police companies’ accounting practices.

At the same time, auditors had become aware of their organizational heterogeneity. In the Pecora investigation and the subsequent lawmaking process, auditors had not spoken with one voice, as the AIA and the ASCPA had both claimed representation, but had put forward separate views on the Acts and to the FTC. This co-existence of two rival organizations led to confusion about the proper source of authority in the regulatory space (Miranti, 1990). In line with Halliday’s (1985) argument, it seemed difficult for auditors to play a regulatory role and wield influence on the SEC without being united in one professional body.

In 1932, Walter A. Staub, President of the New York State Society, began to call for a merger of the two associations, and was eventually invited to the AIA’s October 1933 Council meeting. Facing a “clearly hostile” audience, he argued that the associations’ “competitive relations [...] tended to delay policy decisions on a national scale” (Carey, 1969, p. 355). Similarly, it was difficult for the state societies to cooperate with two organizations, so that any such cooperation was only “lukewarm.” Referring to AIA elitism, he contended that Institute membership would not become “a major national symbol of professional qualification,” since the CPA credential had gained much recognition (Carey, 1969, p. 356). In light of this argument, the Council meeting tepidly approved steps to explore a merger with the ASCPA, but only after individual Council members asserted that resistance came mostly from within the Council, whereas AIA members largely favored a merger (Carey, 1969; also AIA, 1936b). Yet the proposal to form a joint organization had to survive a further AIA president, George Armistead, who, in his 1935 presidential report, likened a merger to “a grafting of a dead limb to a living tree” (American Institute of Accountants (AIA), 1935, p. 219), fearing that the Institute’s prestige and quality would be diluted (Montgomery, 1939). The decision then came down to “the only contest for the office of presidency of the Institute” in its history (Carey, 1969, p. 36). In 1935, two candidates ran on platforms favoring and opposing the union with the ASCPA. Robert H. Montgomery, the pro-merger candidate, prevailed, and a merger took place in 1936, when the AIA became the continuing organization and absorbed the ASCPA.

Auditors’ ability to overcome their preconceived opinions on professional matters and social backgrounds implied that the SEC’s entry into the regulatory space made clear the benefits of professional integration to attain influence on the state (Halliday, 1985). What seemed to matter was the shared interest of auditors in gaining political power and leverage, as well as greater autonomy in what they thought were their own affairs (Miranti, 1990). Uniting the two rival organizations also meant that neither of them could take advantage of the other on the topic of accounting principles, as George May fretted: “If the [ASCPA] takes up this subject and exploits it vigorously, I think they can do the Institute considerable harm and gain a great deal of prestige for themselves” (cited in Miranti, 1990, p. 171). Even if integrating members into one association created homogeneity mostly or only in appearance, it removed a barrier to full professional status and increased the public credibility of auditors’ knowledge claim. It also sent a signal to the SEC and other regulatory actors about auditors’ authority in their primary institutional sphere.

Academics arise as a regulatory actor, 1935-1936

As long as a new institution's information is insufficient, it remains difficult for the regulator to develop an understanding of regulatory issues (Hazgui and Gendron, 2015). Such additional regulatory information arrived at the SEC in the form of the registration statements that listed companies filed in the first six months of 1935. The registration exercise meant that "probably more questions on accounting matters were raised and resolved, rightly or wrongly, than ever before or since in a like period of time" (Blough, 1967, p. 4). The ensuing transparency made clear the diversity of accounting practices, which quickly "became the subject of discussion, criticism, defense and analysis. From [observing this diversity] sprang much of the impetus for the consideration that has been given to the subject of accounting principles" (Blough, 1967, p. 4). So far, the SEC had been making decisions on individual cases only, so that its influence on practice was limited. It also lacked authoritative guidance to enforce compliance with, be it an articulation of accounting principles or an inventory of accepted accounting practices. In light of its reluctance to regulate accounting, the SEC increasingly looked for support from other actors.

The registration exercise also led to the Commission's decision in December 1935 to appoint Carman G. Blough to the new position of Chief Accountant, where he immediately became "the most important individual regulator" in the USA, striving for "more rigorous audits, more serious sanctions against violators, and more uniform accounting standards" (McCraw, 1984, p. 191). In doing so, he often reached out to the senior technical partners of the large audit firms before making judgments on particular accounting questions, which was appreciated by the profession as a constructive relation (Carey, 1969; Zeff, 1972). The Chief Accountant thus maintained the SEC's approach of interacting with and engaging auditors in the regulatory task.

With auditors working to limit the Commission's attention to individual decisions and issues, accounting academics duly registered the need for accounting principles. While still marginal actors in the early 1930s, they had gathered sufficient strength and influential members to enter the regulatory space. The Editor of *The Accounting Review*, Eric L. Kohler (1934, p. 334), emphasized: "For years he has assailed the smugness of the profession and its inability to set standards for its own conduct and for the information of the public that relies upon its findings," suggesting that "the profession is either unwilling or incapable of doing any straightforward thinking on its own behalf." Accusing auditors of an appeasement tactic, Kohler (1934, p. 336) urged academics to "secure for themselves their proper leadership in professional affairs."

Kohler worked as both an academic and auditor, and was reminded of this fact by Thomas H. Sanders, another academic with this dual responsibility[3]. Sanders (1935, p. 100) took a more moderate position because: "It is easy to lay down principles of accounting in stricter terms than those hitherto used, but in order that they may be more generally adhered to, they must be flexible enough to accommodate all the varied conditions to be found in actual business life." In an editorial note, Kohler responded that, in its short life, the SEC had achieved more in terms of effective and reasonable accounting standards than auditors in their committee work. He saw the profession hiding behind its indeterminate knowledge, belittling any need for regulation. In his criticism, Kohler followed the pattern of peripheral actors, who attempt to gain influence by problematizing the status quo in an oppositional and aggressive manner (Bucher *et al.*, 2016).

These calls for involvement resonated with the AAUIA, which reorganized in 1936 into the American Accounting Association (AAA), adding research and the development of accounting principles to the scope of its activities (Zeff, 1966). Given this policy orientation, SEC Commissioner Mathews attended the first meeting of the AAA's Executive Committee, where he emphasized the SEC's need for an authoritative literature (Zeff, 1966). The AAA responded by discussing the subject of accounting principles in its Executive Committee,

which culminated in “A tentative statement of accounting principles affecting corporate reports” (American Accounting Association (AAA), 1936). With a view to developing a “single coordinated body of accounting theory” (p. 188), it proposed three major principles: measurement at cost, an all-inclusive income statement, and a distinction between paid-in capital and earned surplus. Despite this “experimental formulation” (p. 187) and its limited content, the document was a significant step toward accounting principles, primarily because of its more prescriptive nature, as compared to Audits of Corporate Accounts (1934). It was also what the SEC needed: emphasizing the Commission’s “great need for a more generally recognized body of accounting principles,” Blough (1937, p. 30) appreciated the “expression of opinion on significant accounting principles from a body of men whose word may be taken authoritatively by practicing accountants seeking guidance in the many problems that face them.”

While academics engaged in an extensive discourse on the document, the profession, including the editors of the *Journal of Accountancy*, ignored the statement (Greer, 1956), despite the AAA’s attempts to stimulate the discussion (Zeff, 1966). Practitioners had not yet come to terms with accounting principles, and George May wondered “whether it is a correct conception of [academics’] proper sphere that they should take the leadership in professional affairs” (cited in Miranti, 1990, p. 171). While considering academics as peripheral actors and the AAA’s moves as presumptuous, auditors became aware of an emerging threat. Having academics serve the SEC with prescriptive pronouncements was anathema to auditors, challenging that their knowledge could not be codified as well as imperiling their position as the main source of regulatory guidance. Conversely, the AAA successfully exerted influence by making itself known via the strong views of individuals, thus overcoming academics’ general reluctance to organize and mobilize their members (Halliday, 1985). As the SEC relied on the academic input, the AAA was given the regulatory legitimacy to realize its influence. Conceivably, the academic backgrounds of some Commissioners, chiefly Chairman Landis, made them receptive to academic views. As a result, auditors began to fear the emergence of a rival organization (Carey, 1969).

Auditors’ changing knowledge conception, 1936-1938

In the face of building pressure from the SEC and academics, auditors needed to reconsider their epistemological foundation, which so far based on claims of professional judgment and integrity. Codification would imply a regulatory rigidity that would lead to “vocational suicide” (Nissley, 1937, p. 101). This attitude was epitomized by Montgomery’s textbook *Auditing Theory and Practice*, which, in the 1927 edition, ascribed auditors’ significance to their “clear thinking and accurate judgment,” accumulated over years of experience. The 1934 edition criticized regulatory bodies for not fully recognizing auditors’ “skill and good judgment” in attesting that financial statements reflected generally recognized accounting practices[4]. As AIA President, Montgomery further argued that auditors’ “urge to find and tell the truth [...] has made us what we are today,” so if anyone “is able to influence a statement or a report against our best judgment, from that moment the profession will deteriorate” (American Institute of Accountants, 1937, p. 81). The virtue of their task and their personal character uniquely qualified auditors to protect investors. Such a knowledge conception entailed moral and technical authority, as auditors viewed themselves as exercising secret skills for the better of society (Larson, 1977; Halliday, 1985; MacDonald, 1995):

The field of financial accounting is not one in which guidance is to be found wholly in fixed principles – it is a field of shadowy outlines in which the discovery of a correct course depends upon the possession also of an ability to recognize the essential facts and to appreciate their true significance (distinguishing where necessary between form and substance); upon informed and wise judgment; and upon objectiveness and honesty of purpose. It will be observed that these are not qualities which can be insured by regulation (May, 1937, p. 335).

This attitude was also underlying Sanders *et al.*'s (1938) monograph *A Statement of Accounting Principles*. Commissioned in 1935 by the Haskins & Sells Foundation, the book intended to establish "a body of principles which will become useful in unifying thought and which by its acceptance will serve to standardize accounting practices." While indeed becoming an influential sourcebook, it did not provide any authoritative statements of accounting principles, but was rather a survey of accounting practices. The only concrete outcome of the debate was a revision of the AIA's auditing bulletin, which provided additional guidance under the pretext of ensuring the soundness of auditors' judgment (AIA, 1936a). Otherwise, auditors expressed themselves against the articulation of accounting principles and did so in the *Journal of Accountancy*, essay-writing contests and roundtables. Contributions to this debate largely clung to the conception of indeterminate knowledge without bringing forth evidence that judgment was indeed beneficial.

The resulting resistance to the SEC's demand for cooperation resonated with auditors' general recalcitrance as based on received professional ideals (Doron, 2011). That is, the review of the registration statements changed the attitude of the Commissioners, who realized that, by itself, judgment was not the best guiding principle in accounting. While wanting to rely on auditors to narrow the areas of differences in accounting, Commissioners became vexed with the limited support they received and began to suggest that the SEC stood ready to weigh in on the debate. Commissioner Healy (1937, p. 9) suggested that the SEC could assume its authority "to express a few standards as to principles which we believe are accepted by a majority of good accountants, especially of those who do not assume the role of special pleaders for their more lucrative clients." Mimicking the SEC, academics also expressed strong views that challenged auditors. Greer (1938, p. 29) scoffed at the shallowness of "accepted accounting principles" and warned that auditors' "unwillingness to adopt moderate measures of self-regulation eventually leads to more drastic types of regulation from outside." Contributing to the apparition that the SEC might develop prescriptive accounting principles with the help of academics, the Commission began to supply *The Accounting Review*, 1937 with cases on which it had made decisions, to illustrate "the type of reasoning which the Commission tends to follow". Chairman Landis, a long supporter of the SEC following "practical and workable methods of control," also started to doubt that auditors would get involved under May's leadership (Parrish, 1970, p. 208):

The impact of almost daily tilts with accountants, some of them called leaders in their professions, often leaves little doubt that their loyalties to management are stronger than their sense of responsibility to the investor. Such an experience does not lead readily to acquiescence in the plea recently made by one of the leaders of the accounting profession that the form of statement can be less rigidly controlled and left more largely to professional responsibility alone. Simplicity and more adequate presentation is of course an end much to be desired, but a simplicity that misleads is not to be tolerated. The choice here of more or less regulation is an open one for the profession (Landis, 1936, p. 4).

This statement "created considerable disturbance" among auditors, who quickly arranged that the Chief Accountant would discuss with their Committee on Cooperation with the SEC "accounting questions which came before them on which they felt that they should take issue with the accountants who had signed the statements" (Starkey, 1937, p. 436). Subsequent committee reports reproduced this exchange to demonstrate broad agreement on the questions raised by the Chief Accountant. Striving to continue this communicative link, the committee was enlarged to 11 members, devoting itself to questions on registration forms and regulation, but also on accounting principles and procedures.

While the Office of the Chief Accountant had increased the SEC's accounting expertise, it still lacked resources to establish accounting principles itself. Blough continued to believe

that the regulatory initiative rightly lay with auditors, but stressed that they needed to become active, as references to unwritten accounting principles were insufficient:

Almost daily, principles that for years I had thought were definitely accepted among the members of the profession are violated in a registration statement prepared by some accountant in whom I have high confidence. Indeed, an examination of hundreds of statements filed with our Commission almost leads one to the conclusion that aside from the simple rules of double entry bookkeeping, there are very few principles of accounting upon which the accountants of this country are in agreement” (Blough, 1937, p. 31).

The SEC intended to establish accounting principles only “as a last resort” (Blough, 1937, p. 37). Yet, in April 1937, it inaugurated its Accounting Series Release (ASR), in which Blough gave “opinions on accounting principles for the purpose of contributing to the development of uniform standards and practice in major accounting questions” (ASR No. 1). The Chief Accountant, who had not written this foreword, acknowledged that he had been “criticized rather harshly from within the Commission for not bringing out more of these releases” (AIA, 1937, p. 189). Blough, however, did not intend to bring forth new ideas, but wanted to endorse a consensus on accepted accounting practice that was based on “the better thought in the profession” (AIA, 1937, p. 190). Although auditors might “in many instances be better off” with a definite position on accounting principles, he did not see his office as a source of regulation and wanted to issue releases only if “there is a large weight of argument” for a particular accounting practice.

Since not everyone in the Commission shared these views, an “increasingly heated controversy” on accounting policy developed (Blough, 1967, p. 5). This disagreement became apparent under new Chairman William O. Douglas, who sided with Commissioner Healy in his efforts to regulate accounting (Seligman, 2003). Intervention seemed to loom larger, but Douglas’ overall liberal position implied a perhaps half-hearted attempt at revising the SEC’s accounting policy, in particular since he quickly became preoccupied with regulating the NYSE and the over-the-counter market (McCraw, 1984). On accounting, he also found himself outvoted by the other Commissioners, foremost George Mathews, who thought it unwise to “[wrest] guardianship from the hands of the profession” (Mathews, 1938, p. 226). Yet the SEC’s evolving views, along with the altering Commissionership, suggested that regulatory conceptions and actors’ roles were in flux and that auditors began to lose grip on what had seemed to be their regulatory prerogative.

Despite the ASRs’ limited regulatory scope, the series was instrumental in encouraging auditors to act: ASR No. 4, issued in April 1938, revised the Commission’s policy on financial statements by requiring “substantial authoritative support” for accounting practices applied by corporations. The exact kind of support remained undefined, but could come from rules, regulations and other releases by the SEC as well as accounting principles developed by third parties. That is, ASR No. 4 made clear that the SEC had the final say, but gave auditors “a chance to lead the way” (Blough, 1967, p. 6). So as not to lose control of their knowledge, the firms “that had substantial numbers of clients registered with the SEC” soon started discussing ways to meet this challenge (Blough, 1967, p. 7). Auditors needed to admit that their claim to superior judgment and indeterminate knowledge had undermined their authority in the space, so that a decisive effort was needed to retain some control of their knowledge.

The Institute ultimately followed up on a proposal by George May, who suggested an expansion of his CAP. Through several iterations, the Committee had been in place since 1918, when, as a Special Committee on Procedure, it had expressed opinions on questions put before it by auditors, rarely taking definitive positions. As late as 1933, it rejected a suggestion to develop standard forms of financial statements as “entirely outside its scope” of activities. It was only in 1938 that it dared to be more prescriptive. While continuing to debate the need for accounting principles, it recognized the heterogeneity in accounting

practices and saw the SEC as the main source of agreement. Among a range of alternatives, it cautiously referred to an enlarged CAP that would have a research department and “ultimately formulat[e] rules on specific points.” This “more ambitious suggestion” gave a pivotal role to cooperation with the SEC, the NYSE and the AAA to prevent that pronouncements would conflict with other regulatory views. The proposed scheme resonated with the SEC’s “participatory regulation” (McCraw, 1984), which suggested that collaboration between regulatory actors entails broader legitimacy and mitigates challenges from the periphery. As auditors seemed eager to settle the regulatory debate, they aimed to exploit the coalitions they had forged in the previous decade, although doing so implied incomplete control of their knowledge.

In the end, the AIA Council backed such an enlarged Committee, which was set up in late 1938. As the Committee on Cooperation with the SEC was reduced in size, it referred any questions on accounting procedures to the enlarged CAP. The backgrounds of the Committee’s 22 members followed May’s preference for cooperation (Zeff, 1972). While AIA President Collins became the Chairman, George May, as Vice-Chairman, conducted the CAP’s activities. Three members came from academe, with Thomas H. Sanders becoming the Research director. Carman Blough, now at Arthur Andersen, also joined the CAP. His successor at the SEC, William W. Werntz, attended the Committee’s inaugural meeting, along with representatives from other parties, such as the NYSE (AIA, 1939). The Committee could hardly have more posture and it was this authority that differed most compared to previous professional panels. Yet, in line with auditors’ reluctance to move beyond established consensus, the CAP did not engage in decisive regulatory efforts. It did not expect that “the volume of final pronouncements will be large in the immediate future,” but saw its mission as follows (AIA, 1939, pp. 140-141):

The present plan of the committee is to consider specific topics, first of all in relation to the existing state of practice, and to recommend, wherever possible, one or more alternative procedures as being definitely superior in its opinion to other procedures which have received a certain measure of recognition and, at the same time, to express itself adversely in regard to procedures which should in its opinion be regarded as unacceptable.

The CAP also refrained from putting pronouncements to a vote before AIA members, which would have made them binding. Instead, companies could deviate from the rules put forward, although the burden of proof would lie on those who did. The bulletins’ authority thus depended on their general acceptability, inevitably accentuated by the SEC’s enforcement activities. The expansion of the CAP thus reflected auditors’ striving for a limited regulatory scope and showed that it had not completely given up on its indeterminate knowledge conception. As a result, the professional claim that judgment and flexibility should be valued higher than rigid rules left a considerable mark on the first body to set accounting principles.

6. Discussion and conclusion

Professional knowledge is a central element in the professionalization project and formulating a knowledge claim is essential for a profession to wield power in the regulatory space (Halliday 1985; Hancher and Moran, 1989). After the 1929 stock market crash, leading auditors began to claim a stake in the regulatory space, primarily by exploiting the NYSE’s weakening position. They moved quickly to pursue wider audit requirements, which were supported by the NYSE and formalized in the Securities Acts, albeit without auditors’ direct input (Doron, 2015). Given this increased status, auditors interacted with the SEC to shift the Commission’s attention from exercising their regulatory powers in accounting to prescribing financial statement formats. For some time, this knowledge claim seemed sufficient, as the SEC’s focus was on companies, and Commissioners were reluctant to take

regulatory steps in accounting. Yet, when the registration statements were filed with the SEC and the Commission increased its accounting expertise by appointing a Chief Accountant, the regulatory discourse began to change and pressure increased to develop a set of accounting principles. Eventually, auditors responded by expanding the CAP.

This paper has argued that two main factors contributed to the regulatory outcome in the period under investigation. First, the SEC was set up and operated under a model of “participatory regulation” (McCraw, 1984), suggesting that private sector means would be employed to achieve the regulatory end of bringing order to the corporate sector. A key role in this scheme fell to professional groups, among them auditors, who would be engaged as a form of free labor and become regulatory agents (Larsson, 2005). Second, this regulatory conception entailed increased status for the involved professional groups, but conflicted with auditors’ prevailing knowledge claim and understanding of their epistemological basis. That is, the SEC needed a set of codified accounting principles to demand changes in accounting practices and enforce compliance with. Yet auditors viewed such codification as anathema to their professional judgment, as they feared that CPAs would be displaced by technicians (Previts and Merino, 1998). Carefully weighing the benefits of increased influence and autonomy against the specter of uniform accounting, they began to change their knowledge conception toward having a commonly agreed upon set of accounting principles to guide their professional judgment.

This paper studied the shift in auditors’ knowledge conception by analyzing the ways in which professions wield influence on the state using knowledge mandates (Halliday, 1985). In line with Larson (1977) and MacDonald (1995), it has argued that a claim to indeterminate knowledge is insufficient, but that some degree of codification is needed for such a mandate. Auditors could rely on their claim of superior professional judgment only as long as they wanted to advance their work absent any state influence. Once the SEC became involved and had carved out a regulatory role for auditors, pressure built to support the claim for abstract and secret skills by authoritative guidance on accounting. In studying this shift, it has been argued that knowledge mandates might focus too much on the status quo of a profession’s organizational properties, whereas it is the agency of individuals that drives change and determines professional influence. Hancher and Moran’s (1989) regulatory space added such a focus on powerful individuals and regulatory discourses, exposing that auditors were represented and led by outspoken persons, such as George O. May and Robert H. Montgomery.

It also showed that auditors, as well as academics, were divided along geographical lines and social backgrounds, and tensions emerged out of these differences that had a strong impact on regulatory debates and developments. In particular, the split between the elitist AIA and the more egalitarian ASCPA remained unresolved throughout the period (Doron, 2011). It was only the regulatory interactions during the passage of the Securities Acts and with the SEC that made clear to auditors the benefits of a merger in one national association. What affected this decision was both the ability to speak with one voice as well as the fear that one association would exploit the regulatory debates at the expense of the other (Miranti, 1990). The rise of academics further emphasized that the auditors’ heterogeneity constrained their influence and could result in losing control of professional knowledge. Despite the difficulty to overcome preconceived opinions, the merger between AIA and ASCPA confirmed Halliday’s (1985) conjecture that uniting in one national association translates into greater authority to leverage professional influence.

The change in auditors’ knowledge conception was thus initiated by pressure from both the SEC and academics. The Commission’s authoritative power gave the former its leverage, whereas Halliday’s (1985) taxonomy implied that academics’ guidance had only marginal legitimacy, as it was exerted in a secondary sphere. Indeed, auditors did not pay much attention to AAA (1936), but the SEC’s regulatory power provided “A tentative statement of

accounting principles” with authority, so that academics ended up occupying a more central position in the space. As the SEC’s views changed, a regulatory dynamic developed that ultimately could have resulted in a “division of expert labor” between academics and auditors (Evans and Honold, 2007). Yet the Commission’s approval of academics’ initiative was most likely only a signal that, given its need for accounting guidance, the SEC might preempt the auditors’ authority. As none of the actors had formed a clear idea of what is now standard setting, this paper stresses the need for a nuanced understanding of the emergence of regulatory views. Eventually, the Commission’s regulatory power, along with academics’ advance, pressured auditors into a cooperative regulatory solution. Compared to Hazgui and Gendron’s (2015) case of a “hybrid regulatory pattern,” where auditors actively sought alliances with other actors, the present study exposed auditors as largely reactive and as cooperating only under pressure to appease the regulator.

It is thus suggested that today’s standard setting emerged out of auditors’ incomplete control of their professional knowledge. The resulting intricate relations between standard setting and the audit profession imply that attempts to theorize standard setting need to take into account the history behind the process, as many elements of the historical setup and process have persisted until today. This notion relates to the indirect authority of the bodies’ pronouncements, the open and consultative due process, and the role of other parties, in particular the SEC in the US. Theorization attempts might thus need to move beyond criticizing what Botzem (2014) describes as audit firms’ excessive and undue influence on today’s standard setting. Vice versa, studies of the audit profession may need to embrace the role of knowledge in the striving for status and control of the market. Future research could examine how auditors have attempted to gain or retain control of their knowledge, and when an uncoupling between the profession and standard setting began. It can be suggested that the bemoaned decline of auditors’ professionalism (Zeff, 1986) opened up standard setting to other influences, such as the lobbying activities of preparers (Zeff, 2002), to which the boards responded with rhetorical and legitimation strategies (Young, 2014). It is for future research to examine these propositions and other results of the profession’s incomplete knowledge control, which led auditors to occupy an ambiguous position between having a special interest in and partially retreating from standard setting.

Acknowledgement

The author thanks Kees Camfferman, Yasmine Chahed, Sebastian Hoffmann, Roland Königsgruber and Brendan O’Dwyer for their comments on previous versions of the paper, which was also presented at Vrije Universiteit Amsterdam, the 2014 Critical Perspectives on Accounting Conference and the 2015 Workshop on the Politics of Accounting. The author would also like to thank the members of the MUSICA group at Stockholm Business School. Thanks are also due to Lee Parker (editor) and two reviewers for their support and comments in the review process.

Notes

1. During the period of investigation, it was common to speak of auditing as “public accountancy” and as part of an emerging “accounting profession”. The paper primarily uses the term “auditors”, both to avoid confusion with corporate accountants and to acknowledge that auditors were still in the process of establishing professional status.
2. The survey was based on the investment manuals that rating agencies, such as Moody’s, published at the time and that included all publicly traded bond and stock issues, separated into an industrial, public utility, government, and railroad section. Other numbers as to the spread of auditing do not seem available. Yet the editorial speculates: “If the investigation had extended to other sections of the manual, it would probably have revealed an even smaller percentage of audit than appeared among the industrials” (Richardson, 1927, p. 366).

3. Sanders, himself at Harvard University, suspected that academics' activism was also a reaction by Midwestern universities against the Eastern institutions (Miranti, 1990, p. 172).
4. The 1940 edition asserted that auditors' judgment endured amid changing regulations. Yet it showed that auditors had become regulatory agents, as financial statements were now considered management responsibility and auditors were to ensure consistent application of accounting principles. As Power (1992) and Carpenter and Dirsmith (1993) contend, the securities regulation changed audit objectives as well as procedures, and auditors moved from a claim of superior, but vaguely defined judgment to one of similarly mysterious techniques.

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