Measuring The Evolution Of Generally Accepted Accounting Principles

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Abstract

Generally Accepted Accounting Principles (GAAP) guide financial reporting. Although numerous opinions and standards have been issued over the past 45 years, there is little quantitative evidence concerning the degree of change in GAAP. The purpose of this study is to generate a quantitative understanding of the degree of evolution in GAAP since Accounting Research Bulletin (ARB) 43. The results indicate that significant changes are occurring in GAAP. Less than 50% of the GAAP issued in the 1950's and in the 1960's remains in effect today. Furthermore, significant changes have occurred in GAAP issued within just the past 20 years. The primary implication is that GAAP is continually being reviewed and revised in response to investors' and creditors' changing information needs.

Introduction

Generally Accepted Accounting Principles (GAAP) guide corporate financial reporting in the United States. GAAP consists of conventions, rules, and procedures necessary to define accepted accounting practice at a particular time. These principles have gained substantial support either through the actions of authoritative rule-making bodies or through general acceptance of a practice over time because of its universal application by the accounting profession. GAAP is essential to the efficient functioning of the economy because decisions concerning resource allocations rely heavily on credible, concise, and understandable financial reporting. (FASB, 1997).

In recent years the rapid changes occurring in the American business environment have

greatly expanded investor and creditor information needs. As a consequence, it is generally assumed that significant changes have occurred in GAAP over the past five decades to meet these information needs. However, there is little quantitative evidence concerning the extent of change in GAAP. The purpose of this article is to generate an understanding of the degree of evolution in GAAP since Accounting Research Bulletin (ARB) 43. Since many principles and procedures that constitute GAAP have not been formally codified in the form of a pronouncement this study does not purport to measure the entire evolution of GAAP. Rather, this effort concentrates on the changes that have occurred in Statement of Auditing Standards (SAS) No. 69 Category A designated pronouncements, including ARB's, Accounting Principles Board Opinions (APBO's), Statement of Financial Accounting Standards (SFAS's), and Financial Accounting Standards Board Interpretations (FASB

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Interpretations). These Category A designated pronouncements represent primary GAAP. To measure the extent of change in GAAP this study examines the degree to which individual pronouncements have been amended and/or superseded by subsequent pronouncements. The results of this effort should be useful to both the Financial Accounting Standards Board's (FASB) constituencies and to the Board itself in understanding the changing nature of GAAP.

Establishing GAAP

In an effort to correct financial reporting abuses in the early part of this century Congress passed the Securities and Exchange Commission Act of 1934 which established the Securities and Exchange Commission (SEC). The Act gave the SEC the ultimate responsibility for establishing GAAP. However, the SEC has chosen to delegate its authority to the private sector. The SEC encouraged the creation of a private standard-setting body because it believed that the private sector had the resources and talent necessary to develop a body of GAAP.

In response to the SEC the American Institute of Certified Public Accountants (AICPA) established the Committee on Accounting Procedures (CAP). The CAP which came into existence in 1939 issued 51 Accounting Research Bulletins (ARB) until its demise in 1959. The most notable ARB is Number 43 which is a revision and summary of the first 42 ARB's. The CAP was followed by the Accounting Principles Board (APB) which issued 31 APBO's.

Since 1973 the Financial Accounting Standards Board (FASB) has been the designated organization in the private sector for establishing GAAP. The FASB derives its authority from the SEC (Financial Series Release No. 1, Section 1) and the AICPA (Rule 203, Rules of Conduct, as amended May 1973, and May 1979).

In addition to the FASB there are numerous other sources of published guidance describing practices that ought to be used in preparing financial statements. These sources in-

clude various FASB publications, AICPA documents, and other formal and informal guidance. However, the accounting profession has never published a complete, official listing of GAAP. Furthermore, the profession has never precisely defined what is meant by "substantial authoritative support." Additionally, the distinction between GAAP and non-GAAP is often unclear. In an effort to clarify the situation Statement of Auditing Standards No. 69 establishes a hierarchy of GAAP to guide financial statement preparers. At the top of this hierarchy of GAAP are pronouncements of authoritative bodies designated by the AICPA Council to establish accounting principles under Rule 203 of the Code of Professional Conduct. Accordingly, an accountant should follow the accounting principles and procedures indicated in a Rule 203 pronouncement unless unusual circumstances exist that indicate following the pronouncement would cause the financial statements to be misleading. Included in Category A pronouncements are ARB's, APBO's, SFAS's, and FASB Interpretations. It is changes in these pronouncements that are the focus of this study.

In its efforts to establish GAAP the FASB engages in extensive "due process" and seeks input from all segments of its diverse constituency. More specifically, the FASB seeks to: (1) Improve the usefulness of financial reporting by focusing on the primary characteristics of relevance and reliability and on the qualities of comparability and consistency; (2) Keep standards current to reflect changes in methods of doing business and changes in the economic environment; (3) Consider promptly significant areas of deficiency in financial reporting that might be improved through the standard setting process; (4) Promote the international comparability of accounting standards concurrent with improving the quality of financial reporting; and (5) Improve the common understanding of the nature and purposes of information contained in financial reports.

Out of the FASB's process of enhancing GAAP comes two Category A designated pronouncements including: (1) Statement of Finan-

cial Accounting Standards (SFAS): These pronouncements represent primary standards of financial reporting. These pronouncements either amend or supersede previously issued GAAP or provide guidance where none had formally existed before; and (2) FASB Interpretations: The FASB issues Interpretations to clarify, explain, or elaborate on an existing SFAS or the effective pronouncements of its predecessors, the Accounting Principles Board or the Committee on Accounting Procedures. A FASB Interpretation has equivalency to a SFAS.

This research effort extends our knowledge of the workings of the FASB, APB, and CAP by quantifying the degree of change in GAAP to SFAS 131.

Measuring Changes In GAAP

The 51 ARB's, 31 APBO's, 131 SFAS's and the 42 FASB Interpretations issued to date are the primary sources of data for this effort. Although it is difficult to measure the degree of change in GAAP over time, one possible surrogate measure is counts of paragraphs that have been amended and/or superseded as of the latest pronouncement. From each ARB, APBO, SFAS, and FASB Interpretation information was gathered concerning the percentage of the total number of paragraphs that have been amended and/or superseded as of the latest pronouncement, SFAS 131. Paragraphs counted as GAAP are only those that represent "Standards of Financial Accounting and Reporting," "Opinions," or "interpretations." Paragraphs that are "Introductions," "Scope and Applicability," "Appendices" and other peripheral information that do not represent primary GAAP are excluded from this analysis. Furthermore, this study does not differentiate between paragraphs amended or superseded. In either case the paragraph has been altered and, therefore, GAAP has been modified for purposes of this analysis.

Additionally, the individual pronouncements vary significantly in size from two paragraphs (several pronouncements) to a maximum of 110 paragraphs (SFAS 106). To adjust for

size differences a separate percentage figure is calculated for each pronouncement. This figure is based on the number of paragraphs that have been amended and/or superseded as of SFAS 131. This size adjustment enables comparison of percentage figures across GAAP and prevents giving more or less weight to an individual pronouncement on the basis of size.

For example, SFAS 34 (Capitalization of Interest Cost) has 67 paragraphs. Of the 67 paragraphs there are 49 paragraphs of introduction, background information and basis of conclusion. Of the remaining 18 paragraphs that constitute the "Standards of Financial Accounting and Reporting" seven paragraphs (38.9%) have been amended and/or superseded and, therefore, eleven of the original paragraphs remain in effect or 61.1% of the total. If a particular ARB, APBO, SFAS, or FASB Interpretation is entirely superseded by a later pronouncement it is given a one for the proportion of the paragraphs amended and/or superseded and a zero for the proportion in effect at the present time. These individual pronouncement percentage figures are then aggregated by decade of issuance to provide an overall measure of the trend of change in GAAP.

The ARB's present a problem. Although 51 ARB's were issued from 1938 to 1959 ARB 43 represents a revision and summary of the first 42 ARB's. For purposes of analysis each of the 15 chapters of ARB 43 is treated as separate pronouncement. Therefore, 23 ARB pronouncements (15 chapters of ARB 43 and ARB 44 through 51) are analyzed in this study.

Furthermore, there is considerable variation in the scope of the pronouncements that constitute GAAP. Some Category A standards represent substantive changes in financial reporting while other pronouncements amend or interpret GAAP or deal with specialized industry practices. This study provides an understanding of the impact of evolution on the different types of pronouncements that constitute GAAP. Using a classification scheme adapted from Briloff (1986) and Tandy and Wilburn (1992) the fol-

lowing types of standards are analyzed: (1) *Substantive Standard*: sets standards for accounting issues where standards did not previously exist, or completely supersedes prior standards based upon comprehensive reevaluation of the issues; (2) *Amendment*: amends, revises, interprets, clarifies, or supersedes a portion of a previous standard (although an industry specific amendment is classified as an industry standard); and (3) *Industry Standard*: pertains to industry specific accounting issues, or to specialized accounting issues, or to a specialized group of entities such as governmental or not-for-profit. Some standards could be classified as either substantive or amendment pronouncements. To be consistent, pronouncements were classified as amendments only if actually designated as amendments by an authoritative rule making body.

Data Analysis And Results

The following tables present descriptive statistics regarding the percentage of original GAAP pronouncements amended and/or super-

seded as of SFAS 131. These tables show summary figures by decade of issuance as well as information classified by type of pronouncement.

Table 1 presents aggregated information for all pronouncements by decade of issuance. The greatest number of GAAP pronouncements were issued during the 1970-1979 period with 80 while the 1980-1989 decade closely followed with 78 issuances of GAAP. Another measure of activity is the total number of paragraphs of GAAP issued by authoritative bodies. These results indicate that the 1980-1989 period leads with 899 paragraphs while the 1970-1979 period is second with 833 paragraphs.

However, it is interesting to note that even though only 32 pronouncements have been issued so far during the current 1990-1997 period, the average length of a "Standard of Financial Accounting and Reporting" section is 20.2 paragraphs. In comparison the average length of a "Standard," "Opinion," or "Interpretation" during 1980-1989 was 11.5 paragraphs and in 1970-1979 the average length was 10.4. The

Table 1
Percentage of Original GAAP Amended/Superseded as of SFAS 131

Decade Issued:	1953 to 1959	1960 to 1969	1970 to 1979	1980 to 1989	1990 to 1997	Total
Number of Pronouncements of GAAP Issued:	23	15	80	78	31	227
Total Number of Paragraphs:	412	221	833	899	627	2992
Average Number of Paragraphs per Pronouncement:	17.9	14.7	10.4	11.5	20.2	13.2
Percentage of Total Paragraphs Amended/Superseded:	48.8	84.6	48.1	27.3	6.2	35.9
Average Percentage of Individual Pronouncements Amended/Superseded:	63.2	67.8	51.3	35.1	12.8	42.8
Average Percentage of Individual Pronouncements Amended/Superseded by Classification:						
Substantive:	63.2 (23)	87.0 (13)	53.6 (29)	30.4 (17)	5.4 (15)	48.8 (97)
Amendment:	0.0 (1)	48.8 (47)	38.0 (30)	21.7 (10)	42.6 (88)	
Industry:	0.0 (1)	64.0 (4)	34.8 (31)	20.0 (5)	37.1 (41)	
Percentage of Pronouncements 100% in Effect:	13.0 (3)	20.0 (3)	22.5 (18)	38.5 (30)	58.1 (18)	31.7 (72)
Percentage of Pronouncements 100% Amended/Superseded:	43.4 (10)	46.7 (6)	40.0 (32)	28.2 (22)	6.5 (2)	31.7 (72)
Note: Figures in parentheses are number of pronouncements.						

implication is that even though relatively fewer pronouncements have been issued during 1990-1997, the current Board is dealing with relatively more complex issues that require more deliberation and explanation than in previous periods.

The results indicate that there has been significant change in GAAP from ARB 43 to SFAS 131. Of the GAAP issued in the 1953-1959 period 63.2% of the original paragraphs have been modified by a subsequent pronouncement. The average percentage figure decreases to 12.8% for 1990-1997. It is evident that GAAP is rapidly changing to meet the increasingly complex needs of financial statement users. Furthermore, it should be noted that the pronouncements analyzed in this study represent the entire population of Category A GAAP. Therefore, tests of significance are not reported in this study.

Further evidence of significant change in GAAP is that less than 30% of original pronouncements issued in 1950, 1960, and 1970 decades remain 100% in effect as of SFAS 131. Additionally, in excess of 40% of the pronouncements issued during the first three decades have been 100% amended and/or superseded. In contrast, only two pronouncements issued during the current decade have been 100% modified by a subsequent pronouncement.

Significant changes are also noted in a three-way classification of GAAP pronouncements. The majority of the substantive pronouncements issued in the first three decades have been amended and/or superseded by subsequent GAAP. In fact, 86.0% of APBO's issued during the 1960's have been affected by later pronouncements. Similar results are noted for amendment and industry type pronouncements.

Further insight into the evolution of GAAP can be gained by examining changes in each of the four types of SAS No. 69 Category A pronouncements. Table 2 presents information concerning the ARB's. These early pronouncements which provide much of the original foundation for current practice have been largely affected by subsequent pronouncements. In fact, 43.4% of the ARB's have been entirely amended and/or superseded as of SFAS 131.

Similar changes are noted in the APBO's that are presented in Table 3. On average 57.8% of the 31 Opinions issued by the Accounting Principles Board have amended and/or superseded by subsequent GAAP. The average figure for only the 29 substantive APBO's is 61.8%. Furthermore, 35.5% of the APBO's have been entirely amended and/or superseded as of SFAS 131. It is quite clear that much of the FASB's efforts have affected the earlier issued ARB's and APBO's.

Table 2
Percentage of Original ARB's Amended/Superseded as of SPAS 13 1

Decade Issued:	1953-1959
Number of ARB's issued:	23
Total Number of Paragraphs:	412
Average Number of Paragraphs Per ARB	17.9
Percentage of Total Paragraphs Amended/Superseded:	48.8
Average Percentage of Individual ARB's Amended/Superseded	63.2
Average Percentage of Individual ARB's Amended/Superseded by Classification:	
Substantive:	63.2 (23)
Amendment:	
Industry:	
Percentage of ARB's 100% in Effect	13.0 (3)
Percentage of ARB's 100% Amended/ Superseded	43.4 (10)

Note: Figures in parentheses are number of pronouncements.

Table 3
Percentage of Original APBO's Amended/Superseded as of SFAS 13 1

Decade Issued:	1962-1969	1970-1973	Total
Number of APBO's Issued:	15	16	31
Total Number of Paragraphs:	221	257	478
Average Number of Paragraphs per APBO	14.7	16. 1	15.4
Percentage of Total Paragraphs Amended/Superseded:	84.6	33.9	57.3
Average Percentage of Individual APBO's Amended/Superseded:	67.8	48.3	57.8
Average Percentage of Individual APBO's Amended/Superseded by Classification:			
Substantive:	87.0 (13)	48.3 (16)	61.8 (29)
Amendment:	0.0 (1)		0.0 (1)
Industry:	0.0 (1)		0.0 (1)
Percentage of APBO's 100 % in Effect	20.0 (3)	0.0 (0)	9.7 (3)
Percentage of APBO's 100 % Amended/Superseded	46.7 (7)	25.0 (4)	35.5 (11)

Note: Figures in parentheses are number of pronouncements.

Currently, the FASB has authority for issuing Category A pronouncements in the form of SFAS and FASB Interpretations. Table 4 presents information regarding SFAS, while Table 5 shows data for FASB Interpretations. Since its inception in 1973 the FASB has been quite active issuing 131 SFAS (1907 paragraphs) and 42 FASB Interpretations (195 paragraphs). It is apparent that much of the work of the FASB has been to address emerging financial accounting and reporting issues, such as financial instrument derivatives. However, significant effort has been made by the FASB to resolve issues related to current GAAP. In fact, on average 53.3% of the SFAS's issued during the 1973- 1979 period have been modified and this includes 60.2% of the substantive pronouncements. For FASB Interpretations issued during the 1970-1979 period 50.7% of the paragraphs on average have been amended and/or superseded to date. As previously observed, the percentage in effect figures are even greater for ARB's and APBO's.

Additionally, it is noted that of the SFAS's issued during 1973 -1979 only 36.7% remain 100% in effect while 43.3% have been 100% affected by subsequently issued GAAP. It is evident that change occurs in older as well as newer pronouncements.

Furthermore, the FASB began issuing Interpretations in the 1970's to correct problems associated with certain ARB's, APBO's, and previously issued SFAS's (Miller, Redding, and Bahnson, 1994). Since the 1970's Interpretations have rarely been issued with only eight issued in the 1980-1989 period and four issued in 1990-1997. Being relatively narrow in scope FASB Interpretations average 4.6 paragraphs. Again, the results indicate significant changes have occurred in FASB Interpretations issued during 1970-1979. This finding is not a surprising. When substantive GAAP changes its related FASB Interpretations will be affected too.

Conclusion

It is quite apparent from the results of this study that GAAP is not static but is continually being reviewed and revised in response to the changing economic environment and financial reporting user needs. The fact that GAAP is evolving should not be a surprise to the FASB or its constituencies. To be useful to investors and creditors financial reporting must be relevant and reliable. The principles and procedures that guide financial reporting must be current with economic realities to meet user needs.

Furthermore, when a pronouncement is

Table 4
Percentage of Original SFAS's Amended/Superseded as of SFAS 131

Decade Issued:	1973 to 1979	1980 to 1989	1990 to 1997	Total
Number of SFAS Issued:	34	70	27	131
Total Number of Paragraphs:	432	868	607	1907
Average Number of Paragraphs per SFAS:	12.7	12.4	22.5	14.6
Percentage of Total Paragraphs Amended/Superseded:	55.8	26.8	5.8	26.7
Average Percentage of Individual SFAS Amended/Superseded:	53.3	35.8	12.3	35.5
Average Percentage of Individual SFAS Amended/Superseded by Classification:				
Substantive:	60.2 (13)	30.4 (17)	5.4 (15)	30.7 (45)
Amendment:	45.5 (17)	41.4 (22)	21.8 (7)	39.9 (46)
Industry:	64.0 (4)	34.8 (31)	20.0 (5)	67.0 (40)
Percentage of SFAS's 100% in Effect:	20.6 (7)	35.7 (25)	59.3 (16)	36.6 (48)
Percentage of SFAS's 100% Amended/Superseded:	44.1 (15)	28.6 (20)	7.4 (2)	28.2 (37)

Note: Figures in parentheses are number of pronouncements.

Table 5
Percentage of Original FASB Interpretations Amended/Superseded as of SFAS 131

Decade Issued:	1973 to 1979	1980 to 1989	1990 to 1997	Total
Number of FASB Interpretations Issued:	30	8	4	42
Total Number of Paragraphs:	144	31	20	195
Average Number of Paragraphs per FASB Interpretation:	4.8	3.9	5.0	4.6
Percentage of Total Paragraphs Amended/Superseded:	50.7	38.7	20.0	45.6
Average Percentage of Individual FASB Interpretations Amended/Superseded:	50.7	28.6	16.1	13.2
Average Percentage of Individual FASB Interpretations in Effect:				
Substantive:				
Amendment:	50.7 (30)	28.6 (8)	16.1 (4)	43.2 (42)
Industry:				
Percentage of FASB Interpretations 100% in Effect:	36.7 (11)	62.5 (5)	50.0 (2)	42.9 (18)
Percentage of FASB Interpretations 100% Amended/Superseded:	43.3 (13)	25.0 (2)	0.0 (0)	33.3 (14)

Note: Figures in parentheses are number of pronouncements.

amended and/or superseded it does not signify that a prior authoritative body made an error. Rather, it indicates that the economic environment and user information needs have significantly changed to warrant a revision of financial reporting guidelines. Change in GAAP is inevitable and necessary in the future to enhance the usefulness of financial reporting for investors and creditors.

As an agent for change the FASB has a greater arsenal of resources to effect the evolution of GAAP than did its predecessor boards, the CAP or APB. This enables the FASB to be more responsive to the evolving economic environment and user needs. As a consequence, the FASB is able to react with more knowledge of the issues and possible consequences than its predecessors.

Implications For Future Research

The increasing complexity of financial reporting makes analyzing the evolution of GAAP a fertile area for research. Based on the findings of this study there are several avenues for suggested future research. Although this study provides quantitative evidence of the degree of evolution more research is needed into the rationale for changing GAAP. Furthermore, this research approach can be extended to analyze the changes occurring in the accounting standards of other countries, such as Great Britain and Canada. A comparison can be made of the nature and degree of evolution of United States GAAP and the changes occurring in accounting standards of other countries.

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