

Unresolved Methodological Questions at the Cross-section of Accounting and Finance

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This paper based on a request that we canvass our discomfort with some prevailing research methods before an anticipated hostile audience at a recent MEAFA² conference, understandably emerged as a most apt topic with which to honour Bob. The topic is particularly apt for this festschrift as Bob Clift was a contemporary of Ray Chambers, who would have jumped at the opportunity MEAFA gave us. Likewise it would be likely to be received with approbation by Chambers' colleagues and Bob Clift's contemporaries, such as Bob Gibson, Alan Barton and (say) Louis Goldberg. Accordingly, here the focus is on gaining a more scientific form of research to underpin practice. Methods of research into accounting are much broader than the narrow, positivist allegiance pursued almost exclusively for example by some MEAFA members at its previous meetings. To undertake this enquiry we draw upon primarily the works of Ray Chambers, in particular those relating to the development of ideas (1973, 1974a, 1974b, 1980, 1989, 1993) and two unpublished letters of Chambers (1990, 1995b).³ This we think is most appropriate, for Chambers was the best known Australian academic during much of Bob Clift's academic career, certainly so on the international academic stage. Chambers is thus a unique link between Bob Clift and us. A linkage forged by virtue of the matters in dispute during much of Bob's career, matters he was far from backward regarding how he saw them - and our own predilections nurtured by Chambers' participation in that disputation. Against that background the Appendix contains a sample of seven questions from a 1995 Chambers letter to a colleague addressing matters pertinent to 'critical accounting discourse'. These questions are augmented by another set of seven that we related to concerns about positive accounting that we pose here on Chambers' behalf. What follows canvasses unresolved methodological issues. It concentrates in particular on the arguably vacuous attempts to categorise accounting theory and research as either 'positive' or 'normative'. After revisiting the theme a brief overview follows of the setting within which the ideas were canvassed. For exposition purposes we consider two temporal stages – 1950-1970s and the 1990s to the present.

1. Theme

Almost invariably Ray Chambers' enquiries have been labelled *normative*. In a sense that suited him, he preferred to be known as a *thinker*. But it irked him that the normative label was intended by many to be derogatory, not merely categorical. He described research (drawing on, inter alia, the ideas of Simon, 1990:p663) as 'Thinking: that's research!' (Chambers, 1995a). Accordingly, he

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² We expected a 'hostile' audience because of the large scale empirical research undertaken by many of the academics forming MEAFA (Methodological Advances in Financial Accounting).

³ For those unfamiliar with Chambers' concerns in the 1950s and 1960s about the lack of focus on accounting fundamentals in the extant system and his reforms, it is useful to note that his contemporaries acknowledged him to be one of accounting's 'intellectual giants' (e.g Edwards' *Great Twentieth-Century Accounting Thinkers*, (1994), Colasse's *Les Grands Auteurs en Comptabilité* (2005), Moonitz (1982), Mathews (1982) and Staibus (2003)).

Dean & Clarke

actively pursued methods that often enquired deeply in a Jesuitical manner individual instances, individual observations, in need of explanation - in the sense of a deeper understanding. Our primary theme then is that: *contrary to the often levelled criticism, Chambers' approach is defensibly empirical and, indeed, more closely related to the origins of science than are those techniques of enquiry employed arguably by most declared positivists.*

We should not lose sight of the notion of *experience* changing form (at least) from the time of Bacon's *novum organum* and being subsumed by the concept of *facts* – a notion of facts it appears pushing to the backbenches *theoretical imagination, speculation, and inspired guesswork*. Roszak (1986) mused that all rational enquiry rests upon *master ideas* mostly with little of what are known today as *data* to back them up, and as often as not with only a relatively rare, perhaps one-off, observation having sparked the initial interest. Nor should we lose sight either of the repetitive nature of many of the matters (real world problems) into which Chambers enquired. Roszak also noted that 'ideas precede evidential facts' – precede *ceteris paribus* assumptions, no hypotheses - no ideas, no reason to observe, no *facts* to accumulate and analyse mathematically or indeed any other way!

Contrary to popular opinion Chambers was not antagonistic to his detractors who often appeared to have lacked the capacity, the insights or perhaps even the desire to think through problems in the manner he so admired as the well-spring of true scholarship. His point was that until fundamental, *a priori*, issues were resolved there was little purpose in quantitative analyses of aggregative observations of practices that could neither singularly nor aggregatively satisfy the functions of accounting data – such a waste entailed a misuse of good brains, contrary to the canons of a true science.

2. Background

Arguably, Ray Chambers was one of the earliest accounting academics to impose methodological rigour in attempts to develop *his* theory of accounting (Chambers, 1955a, 1955b, 1961, 1966). Those forays provided a breakthrough. Most accounting texts to that time had been manuals of practice containing very little attempt to reason why those practices should be used. He drew upon his observations of the way accounting was influenced by its cognate fields like law, economics, finance, metrology, axiology, linguistics, ethics, etc (see Chambers, 1991) – this provided his empirical domain (his *conceptual framework*) from which to draw the foundations of accounting. For Chambers, the empirical and analytical domains were inextricably linked – trying to categorise things as either normative or positive was a fruitless exercise for him (see especially Chambers, 1980, 1993).

Numerous others would follow or co-exist with Chambers in this pursuit (including Mattessich, Sterling, Stamp, Ijiri, Moonitz, Deinzer and Staubus). This led to the pejorative label - the 'Golden age of accounting theorists' (as introduced by Nelson, 1973, and noted, for example, in Gaffikin, 2000). Gaffikin describes many theorists as having adopted a hypothetico-deductive (HD) approach to theorising. Some drew on their observations of accounting's

Dean & Clarke

functioning to develop postulates, principles and ultimately a general theory of accounting. Chambers (for example, 1955a, 1961 and 1966) sought to derive those elements of his theory forming a domain of accounting, in which the dominating elements – namely, accounting, finance and management, were integrally linked, not isolates. To him that was where the conceptual framework, for example, was naturally sourced, in the legal, social and economic settings in which accounting functions.

In this regard consider the enthusiastic endorsement of Chambers' *Accounting, Evaluation & Economic Behavior* (A,E&EB, 1966) by Maurice Moonitz (in a letter dated 16 May 1972), supporting the award of the DSc Economics to Chambers by The University of Sydney, who opined:

“The book probes more deeply the “foundations” of accounting than any other similar work. The book explores the contributions of related fields in a manner that if not unique, is certainly not equalled by any other work with which I am familiar. For example, I found his Chapter 7, ‘Information and Information Processing’, Chapter 8, ‘Communication’ and Chapter 12, ‘Financial Communication Within Organizations’, to be lucid summaries of the work done recently in those fields, summaries which are superior in many respects to those prepared by scholars in the fields themselves.”

And to provide a fuller assessment of his thoughts Moonitz appended material from his own 1971 UCLA Berkeley Course Notes containing references to Chambers' accounting system described in *A,E&EB*. Points 7 and 8 below are taken from that source:

“7. This book [*A,E&EB*] is more elegant than Mattessich's, more compact, less diffuse. Its scope is narrower since it probes more deeply into the characteristics (including the limits) of the ideal accounting system. Chambers explicitly acknowledges his debt to recent developments in then theories of organization, communication and regulatory systems. Chambers also views accounting as a science:

‘On the ground that accounting is a process of discovery, at getting at the facts which are pertinent to economic categories of action ... we expound the view that it differs in no respect from other empirical sciences.’ *A,E&EB*, p.vi)

8. Chambers leads a group which agrees with Mattessich (and others) on the need for increased rigor in accounting analysis, but disagrees sharply on the concept of the field (scope of accounting). Chambers holds firmly to the notion that accounting is measurement, and that future events cannot be measured. The “actions of men in markets” takes place in the present and require data on present position, as well as estimates (forecasts, predictions) of future events. Accounting properly supplies data on the present position, but it does not properly supply estimates of the future (e.g. in budgeting or even in its valuation procedures).

Dean & Clarke

(UCLA Berkeley Spring 1971 Course Notes appended to letter from Maurice Moonitz, 16 May 1972 to the University of Sydney Registrar in support of Chambers being awarded a *DSc of Economics - USA P202# 12253*).”

In Chambers’ formal submission for his DSc, he explained that his proposed system of accounting was the product of much evidence of concern about the existing (primarily historical cost-based) system of accounting. That evidence comprised two main strands: the *first* was a critical examination of the propositions and justifications which constituted the ‘theory’ of extant accounting (Chambers, 1954, 1955a, 1955b, 1957a, 1960b, 1961, 1963a, 1964a); the *second* was ‘observational’ or ‘empirical’ in nature (1949, 1952, 1955c, 1957b, 1958, 1964b, 1965b). Both strands will be discussed below in terms of Chambers’ views about ‘observation of accounting practice as a method of inquiry’ (Chambers, 1973a, 1973b, 1974b).

Consistent with Kuhn (1962, Chapter 5) Chambers was concerned to examine the *anomalous* or *abnormal accounting practices* as a class of observations. He observed:

“One’s inquiry is directed to finding anomalies – occurrences which, under the prevailing theory or doctrine covering the phenomena, should not have occurred. There are some who decry the use of the anomalous or the abnormal. But it has been a most fruitful source of new beliefs, new knowledge.” (Chambers, 1973b, p. 162)

Direct observation for Chambers often took the form of case analyses such as, for example, when a company failed (was taken over, or revalued its assets and made bonus issues). Chambers’ observations entailed examining events leading up to those events and identifying and comparing the relevant ‘reported’ accounting practices and the subsequently revealed ‘actual’ practices. In such case analyses the *sui generis* company was its own ‘control’ in a scientific controlled ‘test’ sense. That approach was criticised in the accounting literature by *inter alios*, Leftwich and Anderson (1974) - and rebutted by Chambers (especially in 1974b, 1980, 1993). He had provided a strong defence of the method in his 1973 *Abacus* article ‘Observation as a method of inquiry – the background of *Securities and Obscurities*’. Consider, p. 165:

“It did not seem to me, and it still does not seem to me, to be necessary to apply any elaborate statistical processes to the analysis of these cases. Every company is unique; its history, its financial and trading strength, its vulnerability to bidders, its relations with affiliates and financiers and its work force, are unique. The points of time when and the conditions under which any combination of these elements may force the use of a more ‘realistic’ accounting, therefore, likely to be diverse. For these reasons I do not believe there is any greater value, for the study of accounting itself, in knowing what proportion of companies depart from avowed rules or principles, so long as the

Dean & Clarke

proportion is not trivial, or if it is, so long as the magnitudes of the few observed departures are not trivial.”

In November 1971 Chambers submitted a supplementary summary of his work to the University of Sydney for consideration for the DSc in Economics award. There he observed that his evidence showed that periodical financial information, as it was published, diverged in a great many cases and by very great amounts from what should be expected from the official and textbook doctrine. Practical exigencies, indeed, had obliged companies to resort to numerous *ad hoc* and theoretically unjustifiable devices to “rectify” the distortions which arose through adherence, over intervals of different lengths, to the “original cost” rule. It showed that investors and directors – even those who had access to expert advice – were misled on a large scale by companies which had made use of the traditional rules. It showed directors and managers were often embarrassed by, but also often took advantage of, the inadequacy and looseness of the rules avowed by the profession. The evidence pointed in the direction of accounting in terms of the contemporary prices of assets. All was proposed within the context of accounting being understood to be a serviceable technology underpinning commercial transactions, corporate financing and restructuring decisions, being the efficient and equitable basis of taxation levies and the like.

From the late 1960s to the mid-1970s accounting theorising switched from what was described by some pejoratively as 'normative theorising', to what has been described by others as 'positive accounting theorising', probably best summarised in Watts and Zimmerman (1986). Such theorising drew vehement criticisms - most notably were Christenson's concerns about logical issues (1983), to the broader concerns raised by Whittington (1987), Sterling (1990) and Chambers (1993). Here, we provide only a brief assortment from work that was posthumously published by Chambers (2000) 'Science, Technology and Common Sense'. This extract originally appeared as part of the first lecture in the Chambers 1989 Gordon Lecture Series (9 August- 25 October, 1989). That lecture began with:

“Arts and skills are learned by indoctrination and practice. But their understanding and advancement depend on the outcome of rigorous enquiry and, the resultant body of reliable knowledge. Standards, principles and rules are everywhere evident. Is accounting, or can it be, based on firm principles in the same way as other pursuits?”

Chambers explored that theme further in the lecture, arguing that *principles* could be so derived. He returned to the science and art theme in the 11th lecture of that series, titled 'Positive and Normative', concluding:

“What was and what is will never yield what will be or should be - in science or in technology. The positive accounting cult, its origins and style, hubris apart, does it differ from other modes of enquiry and exposition? Is it about accounting? Or accountants? Or about the games managers play? What are its foundations, its consequences?”

Dean & Clarke

Clearly there was unease about the futile attempts to categorise works to accord with the 'normative or positive' dichotomy exacerbated throughout the 1980s and 1990s by Australian accounting theory texts.

The ideas in that 11th in the 1989 Gordon lecture series formed the basis of the March 1993 published critique of the 'PA Cult' in *Abacus*, 'Positive Accounting Theory and the PA Cult'. It augmented Sterling's critique which had appeared in the September 1990 issue of *Abacus*. There, Chambers lamented:

"The literature and practice of conventional accounting is a classic example of double think and double talk ... The work of the PA cult is essentially similar. [After listing a series of its deficiencies, he concludes] The PA cult claims to present theory or a theory, but it actually presents an unsystematic set of propositions liberally buttressed by ad-hoc addenda." (p.24)

3. Methodological Dilemmas at the Interface of Accounting and Finance

Drawing on our understanding of Chambers' works, for exposition and to focus the debate, it is instructive to consider the following matters as the prelude to the fourteen questions reproduced in the Appendix.

1. Chambers posed several questions in his unpublished 1990 collegial letter. These included: "I have, in fact, taken some care to avoid being associated with any particular school of thought, for it seemed to me that philosophical debate – and there was plenty of that – would simply get in the way of the problem-solving that I have regarded as my main concern. I confess I do not yet know what philosophical differences or schools of thought have to do with problem solving. You associate my general stance with the "received view" of method, the HD method. I accept that. But I have never yet come to understand how problems are solved otherwise; ... " (see more on this in point 9 below);
2. Also in that 1990 letter Chambers noted that his first book (*Financial Management*, 1948) was a novel attempt to link accounting and financial administration - this necessitated, if a functional device like accounting were to be serviceable, for the basic financial affairs to be identified and then linked to accounting;
3. As noted in the Background section above and in detail in his 1993 'PA Cult' article, Chambers regarded that attempts to categorise theories as normative or positive are *flawed* and *unproductive* (see also several points below);
4. Chambers' theorising (resulting in his CoCoA system of accounting) produced an accounting system (a measurement and communication system) that adheres to the canons of measurement, but has not empirically been shown on a cost-benefit basis to be superior to other systems of accounting;
5. Contiguously, Chambers' theorising led to the insight that, in order to develop a proper measurement basis, what has been recognised by standards setters as a critical element in an accounting Conceptual

Dean & Clarke

Framework (CF), one needed first to settle once and for all the precise function of accounting (Chambers, 1960a, 1961, 1964a, 1966);

6. Fundamentals remain unresolved. There is a failure to understand the difference between accounting concepts, postulates, principles – as manifest in the ongoing, albeit languishing new millennial IASB/FASB ‘Conceptual Framework (CF)’ exercises;
7. It is highly questionable whether there is merit in evaluating the efficacy of accounting by recourse to correlation tests with share prices. Similarly Chambers had disdain for academics’ (usually uncritical) recourse to the Efficient Markets Hypothesis (EMH). Consider this conclusion (Chambers, 1974a):

“The stock market and operations in it are extraordinarily complex. So complex in fact that it provides opportunity alike for serious scholars to debate its processes, for intermediaries to earn handsome incomes (and some to fail) in it, and for peddlers of tips and advice to gather a wide following in it. Experts who have worked in it for years admit that they understand little of what causes shifts in security prices. But it is almost beyond question, if one is a market-watcher, that non-accounting information and judgments and events have a more severe, a more frequent and a more readily identifiable impact on prices than does accounting information. If anything, accounting may be regarded as the sub-stratum, overlaid by so many other facts, factors and fancies, that what goes on at the market surface has little identifiable relation to what accounts convey. And as the substratum is itself extraordinarily uneven, whatever statistical correlations may be found can scarcely be attributed to the quality of what accounts convey.

Attempts to test alternative accounting rules overlook the fact that financial statements are in fact aggregative and interlocked. And to overlook the possibility that market judgments are based, not on singular aggregates or sub-aggregates, but on patterns of relations. One may ‘like’ a share for its high dividend, but ‘dislike’ it for the company’s low liquidity or high gearing. One may, on balance decide to buy or sell. But what any particular accounting rule has to do with aggregates, ratios and consequential judgments on the ‘balance’ of qualities of a company or a security is confused by the differential effects of all other rules.

The case for using stock market prices, in the aggregate or on the average, as guides to the selection of accounting rules, or as means of resolving accounting debates, is just not proven. Indeed it seems incapable of proof as long as so many of the rules of accounting are ‘independent variables.’”

8. In the 1989 Gordon Lectures Chambers was adamant that accounting was not different from other modes of inquiry - equally 'man-made' as the whole of science and technology - and hence equally man-made as

Dean & Clarke

things such as (say) motor cars, email systems and antibiotics (as pointed out in his 1995 letter). Hence accounting, like those other things, should be evaluated in terms of its serviceability as a technology;

9. Tests of all phenomena require observation. Consider Chambers' thoughts in 'Observation as a Method of Enquiry' (1973) under the subheading: 'Empirical Research':

"This last point - the failure to test accounting proposals by recourse to empirical evidence - has been the subject of criticism by others. (fn 26 below) And it seems to have been suggested that my work, in particular *Accounting, Evaluation and Economic Behavior*, is an example of model building without empirical testing.(fn 27 below) If empirical testing means testing a proposal as a whole in the context in which it is intended to be used, then certainly it has not been tested. But if each of its parts is the outcome of extended and varied observations of particulars, it cannot be said that the proposal lacks empirical support, or in its case that its empirical support is slight. Certainly I did not parade the evidence in *Accounting, Evaluation and Economic Behavior*, and this may have left the impression that that book was not based on empirical evidence. *Securities and Obscurities* was intended to counter that impression. Though much of the evidence it cites is of later date, it is all of the same kind as was available to me in 1963-4 when the former book was written. And there is a far greater amount where it came from - the annals of business and finance - than I have put to use. There may indeed be a like amount of empirical evidence which could be adduced by the supporters of other proposals; but, if there is, it has not attracted their notice; nor mine.

I am not disposed to deny the value of methods of inquiry other than the method I have used. My point is rather that observation of the connection between accounting products and practical affairs has been widely neglected. The traditional ways of seeking to remove defects in accounting - by discussion and debate, depending on the necessarily limited experiences of the participants - are pseudo-scientific, if not ascientific. The method of direct observation is a method particularly appropriate to a field of practice which is not amenable to significant forms of experimentation. It has been very fruitful, at least, to me, as it has been in other fields to others."

Footnotes 26 and 27 related to the above quote

fn 26. For example: 'Accounting theorists have generally evaluated the usefulness of accounting practices by the extent of their agreement with a particular analytical model The shortcoming of this method is that it ignores a significant source of knowledge of the world, namely, the extent to which the

Dean & Clarke

predictions of the model conform to observed behavior'. Ray Ball and Philip Brown, 'An Empirical Evaluation of Accounting Income Numbers', *Journal of Accounting Research*, vol. 6, Autumn 1968, p. 159.

fn 27. For example, in a survey of a decade's research, the book [A,E&EB] is treated under 'a priori' research-prescription without the testing of hypotheses - but not at all under 'empirical' research. Nicholas Dopuch and Lawrence Revsine (Eds.), *Accounting Research 1960-70: A Critical Evaluation*, Center for International Education and Research in Accounting, 1973."

10. Regarding critical theory many of the utterances of critical theorists is a belief that there was the possibility (actuality) of some kind of knowledge that was transcendental (beyond the tests of observation and like pedestrian processes – (Chambers 1995a letter – some questions from which are appended here)."

As noted above, drawing on the 'nature of things' Chambers was not averse to the fact that the ordered business of getting a less faulty idea of how things work (interlock, mutually engage, co-exist, and so on) has proceeded by close observation of particulars and careful use of the verbal and other symbols we use (as theorists - scientists) in dealing mentally or verbally with non-mental things' (see Chambers', 1995a letter). In this context he was unclear how the so-called 'critical theories' have added to or dismissed from the armoury of seekers for reliable knowledge. Such a questioning led to Chambers posing the 19 questions in his 1995 letter, a seven question sample of which is appended to this discussion.

4. Peroration

Here a case has been made for a rethink of the part that unadulterated cerebral effort, synthesis, imagination and passion might play in the development of a better understanding of accounting practice. There is an analogy to a cognate field, like finance. Drawing on Chambers' example of how he went about developing his ideas regarding a defensible function accounting should serve in an ordered society we have pressed the notion of master ideas driving focussed thinking, that ideas precede facts, that empiricism is properly a much wider concept than the narrow misunderstanding of it attributable to many of the avowed positivists (at least from their published works), and that direct observation underpins ideas. As it stands, the papers in the MEAFA workshops to date (including the 2010 conference) address the pervading, very narrow, view of research methodology. It is against that background that we ought to consider the matters in the Appendix flowing primarily from Chambers' 1990 and 1995a letters regarding research methods as they are applied at the interface of accounting and finance.

Finally, we anticipate that this discussion might prompt a question from readers as to what, bearing in mind that he was not engaged in that

Dean & Clarke

correspondence with Chambers, it has to do with Bob Clift. Point is, throughout his career Bob Clift has never taken the party-line regarding the research methods he has employed or the matters he has researched. We know he was regarded an independent thinker by Ray Chambers. We also know by virtue of our close association with Chambers that he enjoyed great comfort from the knowledge that Bob Clift and his kind were active in accounting academe on an international front. That knowledge gave him the fortitude to maintain his fight for his own ideas on research and research methods.

His great regret was that were all too few like Bob Clift around.

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Dean & Clarke

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Dean & Clarke

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Appendix

Questions derived from analysis related to 'Accounting and the PA Cult' (PA 1-7) and in respect of Chambers' 1995 unpublished letter, which listed 19 questions about 'Critical Discourse and Accounting' (CA 1-7)

Panel A – Issues/questions for consideration re 'Accounting and the PA Cult'

- PA 1 – Empirical studies entail a selection of variables under *ceteris paribus* assumptions that would rarely hold?
- PA 2 - It is contestable when using share price series as if the prices are solely influenced by accounting numbers to draw policy implications.
- PA 3 - It would seem that positivist researchers frequently draw on a priori reasoning (of the kind the PA Cult debunk) to develop proxies for the variables used in large database-driven empirical studies - rarely are the actual events or characteristics used, or do the proxies have unequivocal correspondence to the pertinent variables.
- PA 4 - There is contestability when studies analyse which companies use which accounting practices, irrespective of whether the practices are serviceable separately for defensible, identifiable functions of accounting ... or collectively ... (see discussion under 'point 7' in the above text for the questions PA 1-4).
- PA 5 - Is there such a thing as *the* 'scientific method'? And hence, what do positivist researchers mean when they say certain research is 'unscientific'. What is the notion of science to which the positivists contribute? (see discussion in the above text under 'Background and in point 9').
- PA 6 - How is 'Popper's falsification' to be reconciled with the positivists' gambit that 'testing' at the interface of accounting and finance whether (say) 'higher leverage drives the expensing of research and development', using (say) '100s of observations, *is scientific*', but, a sample of one - 'a case study is not'; the inference invited being that the former has information content, that the latter does not. What does 'testing mean' in this type of enquiry?
- PA 7 – Is it generally the case that major discoveries been *made* with single observations? How many can be attributed to the analysis of huge data sets. Does the use of such large datasets serve a different purpose in the scientific, 'discovery' process? (see discussion in the above text especially under point 9 for questions PA 6-7).

Panel B - Questions/issues for consideration re 'Critical Discourse and Accounting'

- CA 1 - Do critical theorists have a distinctive, openly stated program for adding to reliable and exploitable knowledge of non-mental phenomena?
- CA 2 – Do critical theorists believe that there are objects and events and relationships independent of and distinct from the language in which they are described?
- CA 3 – Have critical theorists any idea of what is 'true' or of what is a 'true statement'?
- CA 4 – Do critical theorists believe that methods of thinking about objects and their relationships differ fundamentally for physical, biological and social phenomena?
- CA 5 – Has critical theory any exponents in the fields of, say, biology, engineering, mathematics?
- CA 6 – Do critical theorists hold that HD cannot yield a theory of, or a mode, dependable accounting? (see discussion under 'Background').
- CA 7 – Have critical theorists advanced any propositions or body of propositions claimed to eradicate any of the flaws, inconsistencies, fallacies or fictions of orthodox accounting? [One could ask the same of Positive Accounting?].