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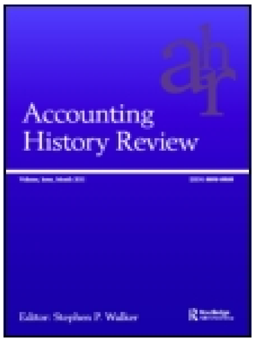


# Financial Statements and Positive Accounting Theory: The Early Contribution of Aldo Amaduzzi

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# Financial Statements and Positive Accounting Theory: The Early Contribution of Aldo Amaduzzi

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ABSTRACT *This paper examines some of the accounting ideas that were developed in the late 1940s by an Italian professor, Aldo Amaduzzi, with regards to positive accounting studies and the content of financial statements. The paper briefly reviews the aim, methodological assumptions and key findings of the so-called 'positive accounting theory' based on the works of the Rochester school of accounting. A content analysis of the early work of Amaduzzi, in relation to his view that the contents of financial statements can be seen as the equilibrium outcome of a conflict of interests between corporate stakeholders, shows that many of the methodological issues on accounting theory stressed by the 'Rochester school of accounting' were raised by Amaduzzi (1947, 1949). The paper concludes that although some key differences between the two approaches do exist, Amaduzzi may be considered as a forerunner of positive accounting theory.*

KEY WORDS: Positive accounting theory, accounting history, financial statements, conflict of interests, Italy, stakeholder theory

## Introduction

Positive accounting theory is considered one of the most innovative as well as 'controversial' (Watts & Zimmerman, 1990: p. 131) theories in accounting since the mid-1970s. The label 'positive' was put after the work of Watts and Zimmerman (1978), published in the *Accounting Review*, which purported to provide 'the beginnings of a positive theory of accounting', although acknowledging that Watts (1974; 1977) had previously 'started to develop such a theory' (Watts & Zimmerman, 1978: pp. 112–113).

This paper seeks to contribute to the so called 'comparative international accounting history' literature (Carnegie & Napier, 2002), by comparing and contrasting Professor Aldo Amaduzzi's thought as a forerunner of positive accounting theory with the self-defined 'Rochester school of accounting' (Jensen, 1976). In particular, the paper will analyse the

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book (entitled *Conflitto ed equilibrio di interessi nel bilancio dell'impresa*) that Amaduzzi wrote in 1949, when he was professor of accounting at the University of Genoa, Italy. In this book, Amaduzzi expanded his analysis on financial statements as the equilibrium outcome of the conflict of interests of disparate stakeholders, an analysis which had already been elaborated, if only *in utero*, in an earlier paper published in the *Italian Journal of Accounting* (*Rivista Italiana di Ragioneria*) (Amaduzzi, 1947).

The critiques of positive accounting theory (e.g. Tinker *et al.*, 1982; Christenson, 1983; Whittington, 1987; Demski, 1988; Williams, 1989; Raffournier, 1990) will not be discussed here. Indeed, they are beyond the scope of this paper, which does not seek to assess the scientific validity of positive accounting theory but rather to examine the work of Amaduzzi for possible signs of an early development of concepts related to positive accounting theory.

The remainder of the paper is organised as follows. In the next section we provide a brief review of positive accounting theory, including its aim, methodological assumptions and key findings as to the content of financial statements. The third section analyses the contribution of Amaduzzi (1947, 1949) and examines his thoughts on positive research in accounting and his findings relating to the content of financial statements. In the fourth section we compare and contrast Amaduzzi's thought with the 'Rochester school of accounting' with regard to methodological issues as well as their findings relating to financial statements. It highlights the key common assumptions as well as the differences between the two academic literatures. We draw together our conclusions in the final section.



## Positive Accounting Theory: Its Aim, Methodology and Findings

Developed during the mid-1970s, positive accounting theory seeks to 'explain why accounting is what it is, why accountants do what they do, and what effects these phenomena have on people and resource utilization' (Jensen, 1976: p. 13). As claimed by Zimmerman (1980: pp. 107–108) 'positive research seeks to develop a theory that can explain observed phenomena'.

More specifically, according to Watts and Zimmerman (1986: p. 2) 'the objective of accounting theory is to explain and predict accounting practice', while normative accounting theory prescribes what the empirical world should be like. In their literature review, Watts and Zimmerman (1990: p. 148) note that 'the term positive differentiated ... [positive] research from traditional normative theories by emphasizing the importance of prediction and explanation'.

Jensen (1983: p. 319) argues that in the period before the mid-1970s (i.e. before the 'beginning' of the works on positive accounting theory) 'accounting theory was predominantly normative. It focused on policy prescriptions for management or public policy [· · ·]. These policy questions are, of course, both interesting and important, and they are best answered with knowledge of a wide range of positive theory – that is, knowledge about how the world behaves.'

In particular, with regard to financial statements, Watts (1977: p. 54) argues that:

> the financial accounting literature concentrates on prescriptions: on what 'should' be the content of financial statements. Very little attention is given to developing a theory to explain many interesting observed phenomena; in particular to explain why financial statements take their current form.

The 'prescriptive' argument against normative theory is also reinforced by Watts and Zimmerman (1979: p. 273).

Positive accounting theory aims '. . . to explain why financial statements take their current form' (Watts, 1977: p. 54). It also aims to produce prescriptions for government accounting policy, i.e. for accounting standards (Watts & Zimmerman, 1986), but the normative aspect is based on 'positive' (i.e. empirical) evidence.

Amongst a few other authors, Watts and Zimmerman (1978, 1990) cite Gordon (1964) as an early positive accounting study, but they do not cite any of Amaduzzi's works. Gordon (1964: p. 251) had argued that 'many accountants are more interested in establishing accounting principles than in considering how one goes about doing so. In fact some accountants merely state 'correct' principles with little or no effort at substantiating their correctness'. With regards to financial statements, Gordon (1964) argues that senior management is likely to select accounting procedures that, 'within the limits of its power', maximise its own utility, by manipulating the information in the financial statements in its own favour.

Given the assumption that 'individuals act to maximise their own utility' (Watts, Zimmerman, 1978: p. 113),[1] Watts (1977: p. 72) asserts that 'the contents of financial statements are the equilibrium outcome of individuals maximising their own self-interests'.

The works of Watts (1977) and, especially, Watts and Zimmerman (1978) gave birth to many quantitative empirical accounting studies that are based on the assumptions of positive accounting theory. For their contribution to the development of accounting studies, both Watts and Zimmerman (1978, 1979) won the American Institute of Certified Public Accountants (AICPA)'s award for a Notable Contribution to the Accounting Literature in the year of their publication. In addition, Watts and Zimmerman (1978) received the 2004 Seminal Contributions to Accounting Literature Award from the American Accounting Association.



## Amaduzzi's Early Contribution to Positive Accounting Theory

Although Professor Aldo Amaduzzi has been considered as one of the 'fathers' of accounting studies in Italy and most of his works (e.g. Amaduzzi, 1953, 1957, 1961, 1981[2]) may be considered as mainstream within the Italian school of accounting, the work that will be analysed in this paper can hardly be considered as mainstream.[3]

In 1949 Amaduzzi published a book entitled, *Conflitto ed equilibrio di interessi nel bilancio dell'impresa*' (literally translated it means, *Conflict and Equilibrium of Interests in Corporate Financial Statements*), in which he employed an early 'stakeholder'[4] approach to analysing the content of financial statements. This book expanded his analysis based on his previous short paper published two years earlier (Amaduzzi, 1947).

Amaduzzi (1949: p. 10) claimed that his aim was to build an accounting theory that is coherent with the real world, i.e. with accounting practice,[5] rather than a theory that prescribes the goal of financial statements (income-oriented vs. 'patrimonial' or 'proprietorial' approach).[6] He stressed that previous accounting studies had not considered the role of the conflict of interests in relation to financial statements,[7] therefore the purpose of his study was to analyse financial statements (and their content) as the equilibrium outcome of a conflict of interests between different corporate stakeholders.[8]

In particular, his aim was to study the appraisal process according to the empirical evidence from corporate practices (Amaduzzi, 1947: p. 142).[9] With such regard, Amaduzzi

(1949: pp. 12–13) pointed out that in financial statements ‘the appraisal process is not necessarily based on objective norms [· · · ] The actual appraisal process in financial statements shows that it is the outcome of an ‘interests’ game’ between different corporate stakeholders’.[10]

Amaduzzi (1949: p. 15ff) identified two main types of interests that have an influence on financial statements: ‘objective’ and ‘subjective’ interests. Although he acknowledged that such a distinction was not clear-cut, he provided a definition for both of them. According to Amaduzzi, ‘objective’ interests are those interests that derive from the corporate system itself, while ‘subjective’ interests are defined as those interests that come from ‘personal’ (i.e. people) needs, alien to an ‘objective’ logic but coherent with stakeholders’ requirements.[11] While ‘objective’ interests are always coherent with company long-term equilibrium, ‘subjective’ interest may act against such equilibrium.[12]

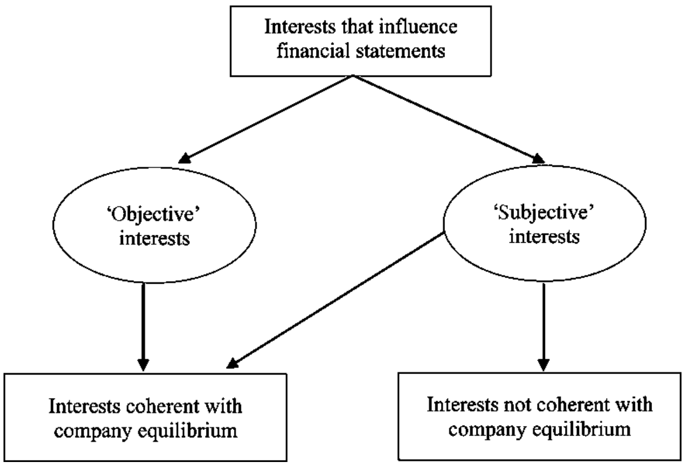


**Figure 1.** Amaduzzi’s taxonomy of interests on financial statements. *Source*: Elaborated from Amaduzzi (1947, 1949)

Among ‘subjective’ interests that may not be coherent with company equilibrium, Amaduzzi discussed the interests related to shareholders, senior management, employees and workers, and public agencies. For example, he discussed the influence on financial statements of the interests of the controlling shareholders. In particular, Amaduzzi (1949: p. 71) noted that since the appraisal process in financial statements has economic consequences, therefore it is likely to follow the interests of the controlling shareholders, even at the expense of the minority shareholders.

Amaduzzi’s remarks differ from those of Gordon (1964) due to the differences in the context in which they were examining accounting and in which, as accounting scholars, they operated (on such issues see, for example, Hopwood, 1983; Carnegie & Napier, 1996). Gordon (1964), like the Rochester scholars, were studying large American corporations, while Amaduzzi analysed the Italian corporate scene. However, there was one fundamental difference between the corporate governance systems that characterised American and Italian companies which influenced their modes of thought: the former were characterised by ‘strong’ managers and ‘weak’ owners (see e.g. Roe, 1994), while the latter by ‘strong’ blockholders and ‘weak’ managers (see e.g. Melis, 2000).

Therefore, *mutatis mutandis*, i.e. taking into account the differences in corporate governance systems, Amaduzzi's argument relating to the appraisal process in financial statements is very similar to the above-mentioned one proposed by Gordon (1964) and advocated by Watts (1977) and Watts and Zimmerman (1978).

## Amaduzzi and the Rochester School of Accounting: A Comparison of Methodological Issues

Amaduzzi's ideas on the content of financial statements as the equilibrium outcome of the conflict of interests between different stakeholders are similar to the arguments expressed by Watts (1977). Moreover, Amaduzzi's claim that an accounting theory needs to be 'coherent' with reality clearly put his ideas within the positive accounting theory framework, although approximately three decades before this framework was developed.

Not only are Amaduzzi's ideas on financial statements and accounting theory in general very similar to those of the Rochester school of accounting, but also with regard to the general framework of analysis he shares some common assumptions with the Rochester school of accounting. First of all, according to the positive accounting theory 'accounting is an integral part of the structure of every organization', therefore 'the development of a theory of organizations will be closely associated with the development of a theory of accounting' (Jensen, 1983: p. 319).

Watts and Zimmerman (1986) thus advocate the importance of applying the methods of economics to the study of accounting, thus pointing out the link between accounting and economics. Furthermore, Watts and Zimmerman (1990: p. 150) point out the link between accounting theory and the study of people behaviour, since 'accounting is an activity carried out by people and one cannot generate a theory that predicts and explains accounting phenomena by ignoring the incentives of the individuals who account'. Such assumptions seem to be very similar to the so called *Economia aziendale* framework, introduced by the Italian accounting scholar Zappa (1927),[13] within which Amaduzzi built up his theories.

Although Amaduzzi's thought shares important assumptions with the Rochester school of accounting, further analysis reveals that some differences do exist. Our analysis below examines the potential differences with regard to important issues such as:

a) the research method employed;
b) the concept of the firm;
c) the position towards 'normative' mainstream accounting studies; and
d) the presence of generally accepted accounting practices (GAAPs) in the framework of analysis.

### *The Research Method: A Visible but Fallacious Difference*

One clear difference would appear to concern the research methods employed. While Amaduzzi used a qualitative research approach, most of the studies within the so called positive accounting theory, particularly when led by scholars from the Rochester school of accounting, have a strong preference for quantitative research methods, in particular the testing of formal hypotheses by means of statistical regression analysis (see, for example, the studies published in the *Journal of Accounting and Economics*, a journal founded by Watts and Zimmerman in 1979 and strongly associated with positive accounting theory).

However, a more in-depth analysis reveals that the qualitative research method employed by Amaduzzi is only apparently in contrast with the assumptions of the Rochester school of accounting. In fact, Jensen (1983: p. 333) clearly asserts the importance of qualitative evidence concerning positive accounting theory research, especially when 'a great deal of work has to be done in a new area of analysis that represents a radical departure from current knowledge before the dimensionality of the problem and the major variables can be defined'. Thus, Jensen (1983: p. 332) stresses the importance of qualitative research methods in early positive accounting studies, such as the one by Amaduzzi.

Therefore, the research method employed cannot really be considered as a key difference between Amaduzzi and the Rochester school of accounting.



### *The Concept of the Firm*

Amaduzzi based his analysis on the content of financial statements on a different framework from the Rochester school of accounting with regard to the concept of the firm. On the one hand, the Rochester school of accounting considers an organisation as 'a legal entity that serves as a nexus for a complex set of contracts (written and unwritten) among disparate individuals' (Jensen, 1983: p. 276).[14] On the other hand, Amaduzzi considered the '*azienda*',[15] as an economic institution designed to persist over time. It is considered as a system of 'economic forces', rather than a mass of things and people, that interact in the production process. Although it is considered as an entity, rather than a 'nexus of contracts', the '*azienda*' does not have its own goals, but is instrumental to the dominant stakeholder (*soggetto economico*) as well as to other corporate stakeholders.

According to the above-mentioned view of the firm, the Rochester scholars adopt a 'positive' agency theory[16] approach to the analysis of the interaction of disparate principals and agents within the nexus of contracts. As Amaduzzi considered the '*azienda*' as an entity, he put such entity in the middle of his framework of analysis and employed an early stakeholder approach to analyse all the interactions that disparate stakeholders, inside (e.g. shareholders, senior management, workers and employees) and outside the company (public administration, confederation of industry, etc.), have with such a corporate entity.

### *The Attitude Towards 'Normative' Mainstream Accounting Studies*

The attitude towards mainstream academic accounting studies represents a key difference between Amaduzzi and the Rochester school of accounting.

On the one hand, the Rochester scholars are well-known for their radical attitude. As for instance, Jensen (1976: p. 11) and Watts (1977: p. 54) assert that normative accounting literature is 'unscientific'. Watts and Zimmerman (1979) may probably be considered as one of the most radical attacks against 'normative' accounting theory, as they make clear that what they name as 'normative theory' is in fact to be considered a non-theory (Watts & Zimmerman, 1979: p. 273 note 1).[17]

On the other hand, although Amaduzzi made clear that his study was different from other mainstream accounting studies, he never had a radical attitude towards the normative accounting literature. In fact, Amaduzzi (1949: p. 7) acknowledged the great relevance of the scientific advances relating to the understanding of financial statements made by accounting studies during the period between the 1920s and the 1940s,[18] and never considered previous accounting literature as non scientific.

*The Framework of Generally Accepted Accounting Principles*

Another difference between the framework in which Amaduzzi and the Rochester scholars built up their theories is due to the presence (or absence) of generally accepted accounting standards in their framework. Amaduzzi's analysis does not include generally accepted accounting principles, while that of the Rochester scholars does.

Amaduzzi's analysis was clearly influenced by time-specific environmental factors: in late 1940s when he wrote his works there were no accounting standards in Italy. Indeed, it might be argued that he wrote that the content of financial statements was the equilibrium outcome of the conflict of interest between different stakeholders only because there were no generally agreed accounting principles (GAAPs) which 'regulated' the content and form of financial statements.

However, accounting theory argues, and empirical evidence confirms (see Healy & Wahlen, 1999; Melis, 2004, for a review of both theory and empirical evidence), that the presence of GAAPs does not (nor can it) eliminate judgement and discretion. Therefore, the conflict of interests that influences the content of financial statements exists even in presence of GAAPs, either within the boundaries of GAAPs (so called 'creative accounting' or 'earnings management'[19]) or outside such boundaries ('false accounting').

Such boundaries are named as the 'accepted set' by Rochester scholars (Watts & Zimmerman, 1986, 1990), whose framework does include GAAPs, but who consider accounting standards to be part of the conflict of interests among disparate individuals (Watts & Zimmerman, 1978), including the members of the accounting standards-setting body (specifically referring to the Financial Accounting Standards Board in the US).

## Concluding Remarks

Positive accounting theory is considered to have been one of the most innovative (and consequently recognised for awards) but 'controversial' theories in accounting literature. Developed in the mid-1970s by scholars of the University of Rochester, positive accounting theory has had a relevant impact on accounting literature, especially in the Anglo-American academic community.

The aim of this paper has been to investigate and examine the works that Amaduzzi, an Italian professor of accounting, wrote in the late 1940s, i.e. approximately three decades before the 'earliest' working paper on positive accounting theory (Watts, 1974), and to discuss to what extent Amaduzzi's work may be considered an early contribution to positive accounting theory. Content analysis of his work reveals that Amaduzzi may indeed be considered a forerunner of positive accounting theory.

Although some key differences (e.g. the concept of the firm and the attitude towards mainstream accounting studies) between Amaduzzi's thought and that of the Rochester school of accounting do exist, they do share some important assumptions concerning:

- the need for 'positive' accounting theory;
- the relationship between accounting theory and organisation theory; and
- the content of financial statements as the equilibrium outcome of the conflict of interests between different corporate agents.

The case of the contribution of Amaduzzi to positive accounting theory seems to support the argument of the ‘multiple origins’ of ideas (Carnegie & Napier, 2002), according to which similar ideas may develop in different time–space contexts independently of one another, rather than developing in one place and subsequently being ‘exported’ to other places over time. In fact, Amaduzzi’s thought was not ‘exported’, as it was unknown to the Rochester accounting scholars, most probably because of the language barrier: all his writings are in the Italian language and have never been translated into English.

Nevertheless, Amaduzzi’s thought may be considered, to be an early ‘hidden’ (to English speakers’ eyes) contribution to positive accounting theory.

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## Notes

1. Furthermore, Watts and Zimmerman (1979: p. 300) assert that ‘the only accounting theory that will provide a set of predictions that are consistent with observed phenomena is one based on self-interest’.
2. Amaduzzi’s entire collection of works includes approximately 40 books and 100 articles written between 1926 and 1991.
3. Amaduzzi’s work is in the Italian language, and has never been translated into English, so that his work is hardly known to non-Italian speaking accounting scholars. The barrier of language is a well-known problem for the dissemination of ideas within the international accounting community (e.g. see Carmona, 2004).
4. Although international accounting and management literature asserts that the term ‘stakeholder’ was used for the very first time in Stewart *et al.* (1963), Guatri (1995: p. 8) notes that Amaduzzi (1949) contains the ‘seeds’ of stakeholder theory.
5. Amaduzzi (1949: p. 11) clarified that ‘il nostro studio può portare su un terreno più rispondente al vero il problema delle valutazioni’ and asserted that: ‘dobbiamo giungere, in materia, alla posizione di principi, alla formazione di un sistema di conoscenza che corrisponda a quanto avviene nella realtà’ (Amaduzzi, 1949: p. 23).
6. For a brief review in English regarding the historical issues relating to the debate in Italy concerning income-oriented accounting vs. capital-based accounting (also known as the ‘patrimonial’ or ‘proprietorial’ approach), see Viganò (1998).
7. Amaduzzi (1949: p. 10) argued that, ‘l’atteggiamento dottrinale sul bilancio non ha colto ancora il conflitto completo degli interessi che in esso si agitano’.
8. Amaduzzi, (1947: p. 142; 1949: p. 10) claimed, ‘noi vedremo il bilancio come sede di un conflitto di interessi, come un luogo ove interessi disparati, che esigono, di per sé considerati, valori diversi, trovano razionale od irrazionale componimento, razionale o irrazionale scissura’. See also his assertion in Amaduzzi (1949: pp. 18–19): ‘lo scopo particolare del presente studio è quello di esaminare il riflesso che il giuoco dei vari gruppi di interessi ha pel sistema dei valori del bilancio di esercizio, per considerare come tale sistema non sia frutto di norme assolute di valutazione’.
9. ‘il nostro studio può portare su un terreno più rispondente al vero il problema delle valutazioni’ (Amaduzzi, 1947: p. 142)
10. ‘*Le valutazioni non sono quindi il frutto di questa o di quella norma ‘razionale’ di valutazione*, non sono frutto solamente della capacità di prevedere, della volontà di giungere a dati risultati di una specie, . . . *Le valutazioni del bilancio sono nella realtà, di cui dobbiamo tenere strettamente conto per teorizzare, il frutto di un giuoco di interessi, parte solo dei quali trova contemperamento nel bilancio*’ (Amaduzzi, 1947: p. 143; 1949: pp. 12–13) (emphasis in the original text).

11. 'Interessi obiettivi sono quelli dettati dalla fenomenologia intrinseca del sistema aziendale, e dell'ambiente che lo circonda; interessi subiettivi sono quelli dettati da aspirazioni di persone, avulse da una logica oggettiva ma intonate ad esigenze di classi, di persone' (Amaduzzi, 1949: p. 16).
12. 'Tali aspirazioni possono essere dettate dalla mira di incrementare il buon governo dell'azienda, così come (al contrario) possono creare un contrasto con le finalità oggettive' (Amaduzzi, 1949: p. 14).
13. See, for example, Galassi (1984), Zan (1994) and Viganò (1998) for a review, in the English language, of the key characteristics of the *Economia aziendale* theoretical framework.
14. The concept of the firm as a 'nexus of contracts' was developed in Jensen and Meckling (1976: p. 310ff), who argued that organisations 'are simply legal fictions which serve as a nexus for a set of contracting relationships among individuals'.
15. For an in-depth review in the English language of the meaning of 'azienda' in the '*Economia aziendale*' framework, see *inter alia*, Viganò (1998).
16. For a definition and review of 'positive theory of agency', in contrast with the so-defined 'principal-agent' literature, see Jensen (1983: p. 334ff).
17. See also Jensen (1976: p. 11): 'in accounting the term "theory" has come to mean normative proposition. The so-called accounting theory texts are almost entirely devoted to the examination of questions of a "what ought to be done" nature. These theories, of course, are not supposed to explain existing phenomena'.
18. 'Gli studi che si son condotti negli ultimi venti anni sul bilancio dell'impresa commerciale, in Italia ed all'estero, hanno segnato un notevole progresso, atto a far comprendere molti aspetti nuovi di quel sistema di simboli che il bilancio rappresenta' (Amaduzzi, 1949: p. 7).
19. Amat & Gowthorpe (2004: 4) note that 'the preferred term in the USA, and consequently in most of the literature on the subject, is 'earnings management', but in Europe the preferred term is "creative accounting"'.



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