

Accounting Historians Notebook

Volume 21
Number 2 *October 1998*

Article 8

October 1998

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Recommended Citation

Chandler, Roy A. (1998) "Exploring the pedigree of the watchdog metaphor," *Accounting Historians Notebook*: Vol. 21 : No. 2 , Article 8.

Available at: https://egrove.olemiss.edu/aah_notebook/vol21/iss2/8

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Chandler: Exploring the pedigree of the watchdog metaphor

EXPLORING THE PEDIGREE OF THE WATCHDOG METAPHOR

by

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The judgement of Lord Lopes, in *Kingston Cotton Mill*, (*The Accountant Law Reports*, May 23, 1896, p. 78), produced what is probably the best known quotation in the auditing literature: "the auditor is a watchdog but not a bloodhound." However, his Lordship's use of the canine analogy was not original; he was merely developing upon a phrase in common parlance at the time.

The first reported use of the watchdog metaphor to appear in *The Accountant* was attributed to an altogether different type of Victorian, the Reverend Dr. Dawson Burns who, more than two years before the Kingston Cotton Mill decision, was quoted as having said:

What is an auditor? He ought to be very much like a watch-dog: very careful to listen for any suspicious sound: able to bark and, perhaps even to bit if necessary. The peculiarity of his position is this, that whereas the watch-dog has to watch those outside, he has to watch those who are inside. He has to take care that those who manage the accounts do their business properly (*The Westminster Gazette* reproduced in *The Accountant*, April 21, 1894, p. 354).

This revelation would perhaps be insignificant were it not for a remarkable irony: the reverend doctor was a director in some of the Balfour companies, a group which included the largest building society in Britain, the Liberator Permanent Building Society, and the London and General Bank (which became involved in the second landmark auditing case of the 1890s). This group was responsible for the biggest crime of the nineteenth century, a fraud involving the loss to investors of a total of £8m. (equivalent to about £400m. at today's prices). The money was lost through the failure of speculative investments and the burden of financing a

lavish lifestyle for the directors. The fraud was masked by various "creative accounting" techniques, which became the blue-print for corporate frauds throughout the twentieth century. Group companies with different year-ends circulated money between themselves to provide a temporary appearance of solvency; intra-group sales at inflated prices produced illusory profits in the accounts of the individual companies; unpaid interest was treated as income; and, the failure to provide for bad debts further overstated profits. Investors received good returns on their deposits and shareholdings but, with no genuine trading profits being earned, these returns were paid out of capital, or more correctly, customers' deposits.

Master-minding this elaborate scheme of deceit was Jebez Balfour, Dr. Burns' brother-in-law. Balfour was able to hoodwink depositors and investors because none of the auditors of the companies in the group possessed the qualities of a true watchdog. In fact, the real position only became known when the cash ran out. The Liberator, and the rest of the Balfour group, collapsed in September 1892 bringing misery to the thousands of savers who had believed the Liberator's slogan, "As safe as the Bank of England." The ensuing panic among investors resulted in a run on other societies, some of which also collapsed. The whole episode set back the building societies' movement by 30 years.

The protagonists also suffered, though not in equal measure. Criminal and civil proceedings were started against those in charge of the group. Balfour, having been extradited from Argentina, was tried, convicted and jailed for 14 years.

The Reverend Dawson Burns escaped this fate and much of the criticism since he had resigned from the board of the Liberator in 1886 on the grounds, according to the

entry in the Dictionary of National Biography, of his disagreement with increases in directors' fees. An alternative rather less forgiving explanation suggested that Burns resigned in order to devote more time to his other directorships in the Balfour group, including the London and General Bank. By withdrawing all his deposits shortly before the group's crash, Burns also made sure that he did not share the same fate as the hapless investors and depositors.

Whatever his faults, Burns, more than Lord Lopes, deserves to be credited with coining the watchdog metaphor, a phrase which immediately became popular with those writing on auditing matters:

I have heard of such things as watchdogs being drugged, and it is even possible that an auditor may be misinformed and led astray by the officers of the company, (a letter to *The Westminster Gazette*, reproduced in *The Accountant*, April 21, 1894, p. 356).

The auditor ought to be the watchdog of the joint stock company, and a watchdog who takes his instruction from the wolf is not of much use in the sheepfold. (*The Financial News* reproduced in *The Accountant*, June 16, 1894, p. 535).

An effective watch-dog, to use the catch word that has found favour in this connection, must be unmuzzled and unchained—how often can it be said that the auditor is not muzzled by the limitations of his powers, and chained by the apathy of his employers?, (*The Accountant*, July 28, 1894, p. 657).

The watch-dog which barks furiously at inoffensive strangers, is far more useful than one which wags its tail at a burglar, (*The Birmingham Gazette* reproduced in *The Accountant*, October 20, 1894, p. 913).

The great bulk of shareholders feel that the auditor is their watch-dog, (*The Western Press* reproduced in *The Accountant*, November 17, 1894, p. 1020).

It is interesting that one writer in par-

ticular, F.W. Pixley, considered the term "watchdog" to be an altogether inappropriate description of the role of auditor. However, Pixley's reluctance to embrace the popular idiom may have been due to his particular predicament—he was facing questions before a court during the inquiry into the bankruptcy of a former audit client, Woodhouse and Rawson United. On June 18, 1894, he strenuously denied that he was in any sense a "watchdog" over the directors (*The Accountant Law Reports*, June 30, 1894, p. 121). In so saying, he was perhaps attempting to distance himself from the actions of the company directors and the consequences thereof.

Although Lord Lopes' remark has frequently been cited by members of the judiciary only one Canadian case has significantly developed the watchdog metaphor, *International Laboratories v. Dewar* (1933 1 DLR 34, reproduced in *The Accountant*, October 28, 1933, pp. 689-703):

As I understand it, the useful work of a watch-dog is based on the fact that he is expected, particularly if he be in the dark, to raise an alarm whenever he sees or hears anything unusual, and, if a possible marauder appears to be approaching, to continue his combined protests and threats with two objects in view: (1) that the cause of the fancied threat be withdrawn; and (2) that his master may be aroused to his danger; and only when one of these objects has been accomplished will he be considered to have discharged the duties of the position which he assumed.

He will not have performed the functions of his office if, after one howl, he retreats "under the barn," or if he confines his protest to a fellow watch-dog.

The watchdog analogy has withstood the test of time so effectively that it is still regularly used in connection not only with auditors, but also with many other oversight or regulatory activities. However, credit for authorship of the phrase should perhaps go to a Victorian clergyman rather than an appellate judge.