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Research on the Evolution of Accounting
Thought and Accounting Practice

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The *Accounting Historians Journal*

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BRIEF NOTE FROM THE NEW EDITOR

I am honored to have been asked take the helm at our journal. I hope to continue in the tradition of my friend and predecessor, Richard Fleischman who poured so much time and energy into this work and who I have not left alone since taking over. He thought he retired – he did not.

My own publication background is almost entirely antiquarian. This is a passion of mine – examining how people accounted for themselves, their lives, their businesses. More than that, what they accounted for – what did they value? Often it was not necessarily what they valued but what they lacked that entered the records. This provides a window into the past not granted by the 'grand' histories. I will not abandon the world of the dusty and crumbling and small.

However, I wish to encourage more critical articles to the journal. We have a strong field of critical researchers to call on for both submissions and review. Please do consider submitting and if you are attending conferences, please encourage presenters of promising papers to submit.

Where are the articles examining accounting's role in the financial crises the world has been suffering through? Surely we should have something to say here.

Let us not forget collaborative work. Much of what we do could be done perhaps better with a sociologist, an anthropologist, an economist, a political scientist, a historian. Bibliographies should make sense – they should be cross-disciplinary.

I hope to see many of you this July in Cardiff at the IPA or Newcastle at the World Congress. If not England, perhaps in Washington, DC in August (what a perfect time to visit DC!).

Gloria Vollmers

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Statement of Policy

The *Accounting Historians Journal* is an international journal that addresses the development of accounting thought and practice. *AHJ* embraces all subject matter related to accounting history, including but not limited to research that provides an historical perspective on contemporary accounting issues.

Authors may find the following guidelines helpful.

1. Authors should provide a clear specification of the research issue or problem addressed and the motivation for the study.

2. Authors should describe the method employed in the research, indicating the extent and manner in which they intend to employ the methodology. Manuscripts are encouraged that draw on a variety of conceptual frameworks and techniques, including those used in other social sciences.

3. Manuscripts that rely on primary sources should contain a statement specifying the original materials or data collected or analyzed and the rationale used in selection of those source materials. Authors should provide the reader information as to how these source materials may be accessed.

4. Authors who use a critical or new theoretical framework to examine prior historical interpretations of the development of accounting thought or practice should include a discussion of the rationale for use of that framework in the manuscript.

5. In performing all analyses, authors should be sensitive to and take adequate account of the social, political, and economic contexts of the time period examined and of other environmental factors.

6. While historians have long debated the ability to assign causation to particular factors, we encourage authors to address and evaluate the probable influences related to the problem or issue examined.

7. Authors should clearly state all their interpretations of results, and the conclusions they draw should be consistent with the original objectives of and data used in the study. Interpretations and conclusions should be clearly linked to the research problem. Authors also should state the implications of the study for future research.

ACCOUNTING HISTORIANS JOURNAL

Guide for Manuscript Submission

Manuscripts for review should be submitted by e-mail attachment to vollmers@umit.maine.edu and formatted in Microsoft Word. The identity of author(s) should not appear on the attached file — only on the accompanying e-mail transmission. Additional correspondence may be sent to Professor Gloria Vollmers, DPC 342, College of Business, Public Policy and Health, University of Maine, Orono, ME, 04469; phone: (207) 581-1979; Fax: (207) 581-1956. There is no submission fee, although authors are urged to consider joining The Academy of Accounting Historians by completing the membership application form on the inside of the back cover. Papers which have been published, accepted for publication elsewhere, or are under consideration by another journal are not invited. The *Accounting Historians Journal* will accept a variety of presentation formats for initial submission as long as the writing style is reflective of careful scholarship. Notwithstanding, authors should attend to the following guidelines:

1. An abstract of approximately 100 words on a page that includes the article's title but no identification of the author(s).
2. A limited number of content footnotes.
3. A limited number of tables, figures, etc., appended at the conclusion of the text, but whose positioning in the narrative is indicated.
4. References are to appear in brackets within the text. Specific page numbers are mandatory for all direct quotes but are optional otherwise.
5. A bibliography of all references cited in the text.
6. Manuscripts should not exceed 10,000 words in length.

Upon acceptance or an invitation to revise and resubmit, authors will be sent a style sheet which must be followed conscientiously for all subsequent revisions of the paper. Once the article is accepted, the editor will request the submission of a diskette prepared in Microsoft Word. If time permits, authors will be sent galley proofs. However, the inclusion of additional material will be severely limited.

Authors will be provided with 3 copies of the *AHJ* issue in which the manuscript is published. Reprints may be ordered by arrangement with the publisher.

NOTE FROM THE EDITOR EMERITUS RICHARD FLEISCHMAN

2011 Manuscript Awards

I am pleased to announce the following winners of the annual *AHJ* Manuscript Competition for Volume 38 (2011) which awards $300 and a plaque for the article judged best by the editorial board and $100 for each of two others for excellence.

WINNER: Jessie Dillard and Linda Ruchala, "Veblen's Placebo: Another Historical Perspective on Administrative Evil"

RUNNERS-UP: John Richard ("Dick") Edwards, "Accounting on English Landed Estates during the Agricultural Revolution – A Textbook Perspective."

Jill Hooks and Ross Stewart, "Farmers, Politics, and Accounting: The History of Standard Values: An Accounting Convenience or Political Arithmetic?"

Congratulations to the authors for these fine pieces of work.

It should be noted that every article in Volume 38 received at least two votes on the ballots submitted.

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Robert J. Kirsch
SOUTHERN CONNECTICUT STATE UNIVERSITY

THE EVOLUTION OF THE RELATIONSHIP BETWEEN THE US FINANCIAL ACCOUNTING STANDARDS BOARD AND THE INTERNATIONAL ACCOUNTING STANDARD SETTERS: 1973-2008

Abstract: Utilizing archival materials as well as personal interviews and correspondence with personnel of the Financial Accounting Standards Board (FASB) and International Accounting Standards Committee /Board (IASC/B), including former Board chairmen and staff members, this paper examines the development of the working relationships between the FASB and the IASC/B from their earliest interactions in 1973 through the transformation of the IASC into the IASB and the Convergence Program rooted in the 2002 Norwalk Agreement up to 2008.

INTRODUCTION

In 1973, two nongovernmental organizations (NGOs) important to the future development of accounting standard setting were established: the International Accounting Standards Committee (IASC) and the US Financial Accounting Standards Board (FASB). Teegen, Doh and Vachani [2004, pp. 463-465] define NGOs as "private, not-for-profit organizations that aim to

Acknowledgements: The author would like to thank Prof. Dr. Klaus Henselmann, Lehrstuhl für Rechnungswesen und Prüfungswesen, Betriebswirtschaftliches Institut, Friedrich-Alexander Universität, Erlangen-Nürnberg, Germany; Prof. Chris Nobes, Fellow ACCA, Professor of Accounting, School of Management, Royal Holloway University of London, UK; Mr. Kurt Ramin, Commercial Director (retired), International Accounting Standards Committee Foundation, London, UK; Prof. Stephen Zeff, Professor of Accounting, Jones Graduate School of Business, Rice University, Houston, TX, USA; Dick Fleischman and Gloria Vollmers, AHJ editors, and three anonymous reviewers for their comments on earlier versions of this paper. The usual disclaimer applies.

serve particular societal interests by focusing advocacy and/or operational efforts on societal, political and economic goals, including equity, education, health, environmental protection and human rights." The emergence of NGOs as institutions filling voids where governments and firms have been unwilling or unable to meet consumer and citizen needs underlines their importance and justifies an examination of their role in globalization. Both the IASC (and its successor, the International Accounting Standards Board, or IASB) and the US FASB have proven to be vital promoters of the globalization of international financial accounting standards.

This paper traces the evolution of the relationship between these organizations through analysis of correspondence preserved in the IASC files located in the archives of the IASC Foundation,[1] as well as analysis of published documents of the FASB and the IASB. It is fleshed out with information from correspondence and interviews with individuals who participated in the developments. The paper proceeds through the following sections: The First Twelve Years; Deepening Contacts: The Next Ten Years; The FASB Seeks to Involve the IASC; The IASC/IOSCO Core Standards Program; the G4+1; Restructuring the IASC; The Strategy Working Party; The FASB/IASB Convergence Program; Summary and Prospect; and Epilog.

THE FIRST TWELVE YEARS

The IASC was founded by the accountancy bodies of nine countries: Australia, Canada, France, Germany, Japan, Mexico, the Netherlands, the United Kingdom and Ireland (UK), and the United States (US) as a private sector NGO. A part-time body of standard setters who met three or four times a year in various cities around the globe, it had a small, full-time secretariat at its London location.[2]

[1] On July 1, 2010, the IASC Foundation changed its name to the International Financial Reporting Standards Foundation. This paper employs the historically accurate names for the periods covered.

[2] "There is an important contrast between the IASC and the FASB. The IASC was set up by the accounting institutes (certain people in particular) who believed that the accountancy profession should set accounting standards. The US had gone through that experience and had moved on to the idea of an independent standard setter. So the two bodies were constituted differently and so may have approached standard setting and standards on particular topics in different ways." David Cairns, emails to the author, September 11, and December 15, 2011.

Table 1.

Chairmen and Secretaries(-General)

Chairmen of IASC	**Period**	**Origin**
Sir Henry Benson	1973 - 76	UK & Ireland
Joseph P. Cummings	1976 - 78	US
John A. Hepworth	1978 - 80	Australia
J.A. (Hans) Burggraaff	1980 - 82	Netherlands
Stephen Elliott	1982 - 85	Canada
John L. Kirkpatrick	1985 - 87	UK & Ireland
Georges Barthès de Ruyter	1987 - 90	France
Art Wyatt	1990 - 92	US
Eiichi Shiratori	1993 - 95	Japan
Michael Sharpe	1995 - 97	Australia
Stig Enevoldsen	1998 - 2000	Denmark
Tom Jones	2000 – 01	US/UK
Chairman of IASB		
Sir David Tweedie	2001 –11	UK
Secretaries to 1983; Secretaries-General from 1984		
Paul Rosenfield	1973 - 75	US
W.J. (John) Brennan	1975 - 77	Canada
Roy C. Nash	1977 - 79	US
Allan V.C. Cook	1979 - 81	UK
Geoffrey B. Mitchell	1981 - 85	Australia
David Cairns	1985 - 94	UK
Sir Bryan Carsberg	1995 - 2001	UK

Adapted from Robert J. Kirsch (2006), *The International Accounting Standards Committee: A Political History*. London: CCH/WoltersKluwer, Appendix 1, p. 381.

The FASB was founded in 1973. Its creation was based upon the recommendations of the 1972 Wheat Committee of the American Institute of Certified Public Accountants (AICPA) to replace its predecessor, the eighteen-member Accounting Principles Board (APB), which was controlled by the profession. The FASB was established to ensure that its seven full-time standard setters acted in the interests of financial statement users. The Board was composed of former auditors, preparers, and users of financial information [Miller, Redding and Bahnson, 1994, pp. 36-38]; traditionally, one member came from academe.

The FASB's authority derives from the Securities and Exchange Commission (SEC), which, since its founding in 1934, has looked to private-sector NGOs to provide directions for financial reporting practices and now recognizes their standards as "authoritative" and "generally accepted" for purposes of US federal securities laws.[3] With respect to non-public companies, the FASB's authority comes from the AICPA and its requirements governing the responsibilities of auditors who are AICPA members.[4] Thus, the FASB operates within a regulatory environment that may limit its independence, whereas the IASC and, until recently, its successor, the IASB, did not. However, the need for the IASC to get its standards accepted by national bodies may have circumscribed its independence, or at least the independence of some of the organizations or representatives on its board. The same issue arises with the IASB.[5] This is quite evident, for example, in the EU decision to endorse IAS 39 with reservations, i.e., "carve-outs."

Table 2.

FASB Chairmen and Their Terms of Service

Marshall S. Armstrong	November 1, 1972 – December 31, 1977
Donald J. Kirk	January 1, 1978 – December 31, 1986
Dennis R. Beresford	January 1, 1987 – June 30, 1997
Edmund L. Jenkins	July 1, 1997 – June 30, 2002
Robert H. Herz	July 1, 2002 – September 30, 2010
Leslie F. Seidman	October 1, 2010 –

Source: Charry D. Boris, Manager, Library Services, Financial Accounting Foundation.

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[3] See "Statement of Policy on the Establishment and Improvement of Accounting Principles and Standards," Accounting Series Release No. 150, December 20, 1973, and "Policy Statement Reaffirming the Status of the FASB as a Designated Private-Sector Standard Setter," Securities Act Release No. 33-8221, April 23, 2003, available at *www.sec/gov/rules/policy/33-8221.htm*.

[4] Edmund L. Jenkins, letter to author, September 14, 2008.

[5] "The IASC was not independent of the accountancy bodies although it did have the power to set its own standards without the approval of those bodies – but, of course, the bodies appointed the people who voted. The IASB has always been independent of the accountancy bodies. The IASB/IASCF structure was very much modelled on the then FASB/FAF structure – thanks to SEC pressure which you mention later – so, the IASB was and is as independent as the FASB - but, of course, the IASC did not derive its authority from any particular jurisdiction"; and "As you explain, both the IASB and FASB are susceptible to pressure/lobbying from various sources – and both may find that those who give authority do not accept what they do. In other words, the SEC has not accepted some FASB requirements or proposals and specific jurisdictions have not accepted IASB requirements. Similarly, the US Congress has objected to some FASB requirements/proposals and the equivalent bodies in other jurisdictions have objected to some IASB requirements/proposals. The only difference between the FASB and the IASB is that the FASB is dealing with one jurisdiction whereas the IASB is dealing with multiple jurisdcitions which have varying traditions." (David Cairns, emails to author, October 27, 2008, and September 15, 2011)

In the first few years of the IASC's basic standards phase there was limited contact between it and the FASB. What contact they had was rather formal. Consider the following example. On September 14, 1973, IASC Secretary Paul Rosenfield wrote FASB Chairman Marshall Armstrong:

> …I am writing this letter to you *in my private capacity* (italics added) and not as Secretary of the IASC to ask how liaison between the two bodies should be established. Should the IASC be in direct formal contact with the FASB, or should formal contact be through the AICPA or other American bodies?

Armstrong's September 18, 1973, letter of response to Rosenfield stated:

> In my judgment, inasmuch as the AICPA is the member organization of the IASC, liaison with the FASB should be through the AICPA, rather than directly with us, although I hope that you will feel free to call on me personally if you feel I might be of assistance.[6]

Thus, Armstrong left the door open to direct communication. In the future, direct contact between the IASC and the FASB became routine.

However, in the early years, the IASC, created by professional accountancy bodies rather than standard-setting bodies, insisted that contacts with national standard setters should be channeled through the related IASC national member body. This was still the case when Hans Burggraaff served as the fourth IASC Chairman, 1980-1982. When he visited FASB Chairman Don Kirk in May 1981, Burggraaff got prior permission from the AICPA President.[7] When David Cairns joined the IASC as its Secretary-General in 1985, it was explained to him that any contact between the IASC and national standard-setting bodies had to be made through the member accountancy bodies in that country. He drew the ire of the Institutes in both Canada and the UK for talking directly to people in their respective standard-setting bodies. As he has noted, "The AICPA was perhaps more relaxed about this (perhaps because they did not expect the IASC and the FASB to reach a joint conclusion in private)."[8] In those early years, it was generally thought within IASC that the accounting profession should set accounting standards and enforce their ac-

[6] IASC Archive File, FASB.

[7] Hans Burggraaff, email to author, September 8, 2008.

[8] David Cairns, email to author, October 27, 2008.

ceptance and application, and that it was capable of doing both.[9]

While direct contacts between the FASB and the IASC were rare at this time, the FASB was very much aware of the IASC's standard-setting work and the SEC's reaction to it. Camfferman and Zeff [2007, pp. 157-160] recount a controversy among the Financial Executives Institute (FEI), the SEC, and the FASB over a proposal in IASC's December 1974 Exposure Draft 3 (E3), *Consolidated Financial Statements,* that all subsidiaries, not excepting banking, insurance, and finance subsidiaries of industrial parents, be consolidated. GAAP of the time excepted the inclusion of such subsidiaries. On June 10, 1975, John C. Burton, SEC Chief Accountant, wrote the AICPA that E3 was "not inconsistent" with GAAP and that the SEC would propose amendments to Regulation S-X "which will conform its consolidation rules" to those in E3 if the FASB issued no statement to the contrary. After seeing Burton's letter, FASB Chairman Armstrong wrote SEC Chairman Ray Garrett, Jr., that "the proposed action could seriously undermine" the FASB by weakening its recognized authority and causing a loss of financial support. Garrett responded to Armstrong [Camfferman and Zeff, 2007, pp. 159-160]:

> It seems clear that all efforts at an international level cannot be expected to adopt an American solution. It seems even clearer that proposed solutions at such a level may be considered for possible adoption [in the US] without upsetting the authority of the Board when the Board has not yet decided to deal with the issue.

In the same letter, Garrett commented:

> The Commission [is] witnessing an influx of foreign registrants… [T]he adoption of international standards will achieve improved comparability in an environment which is currently riddled with exceptions. We therefore have viewed with favor the development of the IASC and our [Burton] letter was designed to express our support for their international objectives.

The two-year-old FASB took an egocentric posture, while the SEC had a broader view in supporting the work of the IASC, even at this early date.

Reciprocal FASB/IASC meetings began to occur regularly in 1975. Camfferman and Zeff [2007, pp. 161-162] recount two FASB/IASC meetings in 1976 and 1977. On March 23, 1976,

[9] Hans Burggraaff, email to author, September 8, 2008.

an IASC steering committee chairman, Alex Mackenzie, met two staff members in the FASB's office. Mackenzie reported that Marshall Armstrong had said, "As regards the problem of reconciling domestic and international standards his approach was 'conference and not confrontation.'" The second meeting occurred in November 1977. On December 7, Armstrong wrote William P. Hauworth, II, Chairman of the AICPA's international technical subcommittee, that the meeting with the IASC representatives was helpful and that the FASB would consider the underlying reasoning of IASs 1-6 whenever the FASB undertook projects in which such positions would be "relevant."

On February 14, 1980, IASC Secretary Allan Cook met the FASB staff in Stamford, Connecticut. Following that meeting, Moshe S. Levitin, FASB Technical Associate, sent Cook a draft memorandum of the meeting for his review. In the section dealing with the relationship of the FASB with the IASC, the draft indicated:

> Mr. Cook stated that because of recent criticism that IASC standards reflect the views of a small group, the IASC wants more input from bodies such as the FASB and the European Economic Community [EEC]. He indicated that the IASC Board will shortly consider formal FASB involvement. Mr. Walters [FASB Board Member] stated his belief that the FASB might be receptive to the idea of increased involvement in IASC activities. Perhaps a nonvoting permanent observer at IASC meetings should be considered. Messrs. Cook and Nash [of the IASC] indicated that the matter will be discussed further among the IASC members and with the AICPA representatives.[10]

This quote reveals that the IASC staff coupled increased FASB participation in IASC activities with extension of the same privileges to the EEC; they would continue this strategy until both accepted observer membership on the IASC Board. It is also interesting that it was an FASB Member who first suggested the FASB become a permanent observer of the IASC Board. The FASB would repeatedly make the request in the years ahead.

Levitin's draft memorandum next dealt with accounting for grants received from governments; it explained that the FASB staff had recommended waiting until the IASC issued its standard and then incorporate it into an FASB document which "would indicate tangible support for international harmoniza-

[10] Kirsch (1996), pp. 157-158.

tion of accounting standards."

On foreign currency translation,[11] Levitin noted that Cook had stated the IASC's desire to participate in and to assist with the current effort to harmonize FTC accounting standards in the US, Canada, and the UK. Subsequently, Cook received an invitation to join the FASB's Task Force on Foreign Currency.[12] With the authorization of Chairman John Hepworth, Cook accepted the invitation.[13]

Despite the February 14, 1980, discussion of possible non-voting observer member status for the FASB at IASC meetings, in June 1980 the IASC Board agreed to "not invite FASB as observer." It acknowledged the previous good efforts of the FASB staff on behalf of the IASC, but it was not yet ready to admit the FASB to Board member observer status.[14] In the July 1982 issue of *World Accounting Report* (WAR), Peter Mantle reported that IASC Chairman Hans Burggraaff explained that the IASC had made a conscious decision "to seek a unification of the accounting profession, not of the standard setters (p. 5)."

> [In the first part of my term] there was no urgency to liaise with national standard setters, and that was the case too as regards FASB. It was only in the second part of my term [that] the [IASC] Board began to realize that, in order to make our standards stick, we needed the support from all parties – preparers, users, standard

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[11] In March 1979, the FASB appointed a 14-member task force to advise the Board with respect to its project to reconsider Statement No. 8, "Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements." *FASB Status Report*, No. 83, March 15, 1979, p.1.

[12] David Cairns, email to author, October 27, 2008. "Allan Cook ...was the only IASC secretary to come from a large multinational company and had a particular interest in foreign currency translation. My understanding is that he played a major part in obtaining the resolution of the issue, in particular the approach taken in FAS 52."

[13] In December 1981, the *FASB Status Report* announced that Statement No. 52, a new foreign currency translation standard, replaced Statement No. 8. The Board acknowledged the assistance it received from the fourteen-member Advisory Task Force, as well as observers representing the IASC, the UK and Ireland Accounting Standards Committee, and the Canadian Institute of Chartered Accountants.

[14] David Cairns, email to author, October 27, 2008. "While [the IASC] knew that the technical contribution of the FASB and the European Commission would be different, it had to involve them both for political reasons. This proved to be true when, eventually, the FASB and the European Commission later attended board meetings. The FASB often had substantive technical comments to make. The European Commission's comments tended to be limited to the text (or the interpretation of the text) of the Fourth and Seventh Directives."

> setters, regulators. And that made liasion with national standard setters necessary. To make them aware of our existence, to foster a positive and friendly attitude, to request input and comment on drafts, and to urge them to consider whether they could harmonize their standards with ours."[15]

Thus, contacts between the two organizations continued. On May 31, 1981, IASC Chairman Burggraaff reported on a conversation he had had with FASB Chairman Don Kirk on May 13, 1981:

> [Regarding Accounting for Income Taxes] I suggested to constitute a working party, consisting of representatives of US, UK, and Dutch standard setting bodies, chaired by a representative of IASC to explore…whether a common solution could be found. The fact that a joint approach to the treatment of foreign-currency-translation had proved to be productive, had led the Board of IASC to believe that a similar approach to the annoying problem of deferred taxation might contribute to international harmonization.
>
> Mr. Kirk pointed out that he was very much in favor of international harmonization. However, FASB had to adhere to its rules of due process, and he was not in a position to negociate [*sic*] international agreements.
>
> Mr. Kirk will let me know in due course whether FASB would be inclined to participate in a working party.[16]

Contacts continued on other levels as well. On May 21, 1981, Secretary Cook wrote Kirk that at a recent meeting the IASC Board agreed, at the discretion of the Chairman, to invite guests to attend Board meetings, and he invited him to the June 1981 meeting. He stated that Burggraaff would be happy to invite Kirk to speak if he chose to do so, even though guests would not normally be expected to participate in the discussions. Cook added, "You may like to know that a similar invitation is being sent to the European commission."

Kirk did attend.[17] On July 2, 1981, he wrote to Burggraaff to thank him for the invitation. Kirk commented, "I was most impressed with the Committee members and with the caliber of

[15] Hans Burggraaff, email to the author, September 8, 2008.

[16] IASC Archive File. FASB. Ultimately, the FASB and the IASC did cooperate on the development of their respective Income Tax Standards.

[17] IASC Board Meeting Minutes, London, June 23-26, 1981.

the discussion."

Further meetings followed. In January 1982 and November 1983, IASC representatives visited the FASB in Connecticut. The November IASC delegation consisted of Chairman Steve Elliott, Secretary-General Geoffrey Mitchell, and Paul Rosenfield, now Staff Observer for the US. The IASC file note of the meeting is instructive. First, the delegation met with Ralph Walters, FASB Member, and Jim Leisenring, FASB Director of Research and Technical Activities. Elliott indicated that it was IASC's wish that enterprises that traded internationally or whose securities were traded internationally would state that they complied with IASs.[18] Elliott indicated that it was unfortunate that the FASB was not part of the IASC Board. He asked if there was some way in which the two standard-setting organizations could "become closer."

Later that day, Elliott met with Kirk and invited him to attend a meeting of the IASC Board during 1984. Elliott raised the possibility of FASB becoming more closely involved in the work of IASC, perhaps through involvement in IASC's Consultative Group.[19] Kirk expressed interest in this suggestion and agreed to discuss the matter further.

Near the end of his term, in December 1983, FASB Member Walters's remarks at a meeting of the FASB and the Arthur Andersen Public Review Board were reflective of the situation at the time. Walters observed that the FASB had no official role or relationship with the IASC. The AICPA represented the US because the IASC comprised national professional bodies. He observed, "The FASB's attitude toward the IASC has been a mixture of unofficial encouragement, moral support, and benign neglect." The FASB staff monitored IASC activities and reviewed and commented upon IASC exposure drafts. But the Board did not normally consider or take a position on IASC standards. Limited contact and liaison had occurred between

[18] David Cairns, email to author, October 27, 2008. "Both Stephen Elliott and John Kirkpatrick devoted a considerable amount of effort to persuading companies who traded internationally or whose securities traded internationally to state that their financial statements complied with IAS (as well as appropriate national standards). Elliott had announced this policy at the 1982 World Congress. Kirkpatrick (who was my first chairman) pushed this policy in every speech. It is not an easy policy to persuade national standard setting bodies to accept. It is doubtful that the FASB would have had any reason to support such a policy."

[19] In 1981, the IASC established the Consultative Group of outside experts. The Group met twice a year with the IASC Board and provided input on the IASC's technical agenda, its work program, and its broader strategy. David Cairns has indicated that some Consultative Group members participated on IASC Steering Committees (Kirsch, 2006, p. 112).

the two groups, usually initiated by the IASC, whose chairman and secretary had visited the FASB a number of times. IASC had supplied representatives for FASB task forces on projects of strong common interest, such as foreign currency translation and income tax allocation. The FASB chairman had attended an IASC meeting in London in 1981. The vice chairman of the FASB is a member of an IASC steering committee on income tax allocation. "Overall, the FASB is aware of IASC activities and reacts positively to IASC's requests but does not take the initiative in the relationship," noted Walters. He continued:

> The absence of the most influential standard-setting body in the free world from the IASC is an anomaly.[20] From time to time, leadership of the IASC has considered whether the FASB should become a member. The FASB has not sought or encouraged consideration of membership on the IASC. The Board's Rules of Procedure would make it difficult if not impossible for it to assume a voting membership on the IASC board.

The position of the FASB toward other international bodies, such as the United Nations and the Organization for Economic Cooperation and Development, was to suggest they support the IASC and stay out of the standard-setting process. Walters observed, "International harmonization has a low priority at the FASB. The subject is not even mentioned in the statement of the FASB's mission….It is inconceivable to me that the standard-setting body for the US will not become involved in establishing international standards."[21]

There were divisions within the FASB over participation

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[20] David Cairns, email to author, October 27, 2008. "There were some in the IASC that felt the same way. Others did not feel that way … because they believed the profession should control standard setting. The [following] response from Don Kirk places emphasis on the needs of users in financial statements in capital markets. The USA is, possibly, unique in that many entities are not required to file financial statements with some regulatory authority. Therefore, the FASB has concentrated on those companies that raise capital on US public markets. In contrast, the IASC developed accounting standards that had to apply to all companies (public and private). As the IASC shifted its focus to companies on international capital markets in the early 1990s, the co-operation between the IASC and the FASB increased."

[21] For the texts of Walters's remarks and Kirk's response, see *FASB Status Report*, No. 154, March 12, 1984, pp. 5-8. Support for Walters's observation is evident by the absence of mention of the IASC or IAS in the paper Donald Kirk presented to the Arthur Young Professors Roundtable in May 1983. See: "The FASB After Ten Years: An Inside View: A Paper by Donald J. Kirk, Chairman, Financial Accounting Standards Board," in Bricker and Previts, 2002, pp. 9-27.

with the IASC. This is reflected in FASB Chairman Donald J. Kirk's response to Walters. Kirk observed that because of legal requirements and American expectations, the FASB must concentrate on its mission to develop standards for entities that issue financial reports in accordance with GAAP. With respect to direct participation by the FASB in the IASC, "that is not feasible under the IASC's present charter and the Board's own Rules of Procedure." Were those circumstances to change, it would be awkward for the FASB to participate in setting standards that inevitably would differ in important respects from FASB's own standards.

These were the formative years of both the FASB and the IASC. FASB had plenty to deal with domestically as its standards were criticized as too detailed and costly for small and mid-sized entities.[22] The IASC was busy establishing its international bona fides, introducing its initial standards, and measuring their impact.[23]

DEEPENING CONTACTS: THE NEXT TEN YEARS

In 1986, the Financial Accounting Foundation announced the appointment of Dennis R. Beresford as FASB Chairman. Among the experiences Beresford brought to the Board was service as US IASC representative, 1982-84. With Beresford's assumption of the Chairmanship, the FASB began to take a greater interest in international accounting matters.

Criticism of the IASC's many permissible alternative accounting treatments by members of the profession and national standard setters led to the launching of its Comparability/Improvements projects. At its March 1987 meeting, the IASC Board appointed a Steering Committee, chaired by Ralph Walters, now representing the AICPA on the IASC Board, to use the IASC *Framework* "to test the validity of alternative treatments and decide whether they are acceptable." This became the IASC's Comparability Project, and led to E 32, *Comparability of Financial Statements* [Kirsch, 2006, pp. 182-184].

On July 3, 1987, Walters spoke to Secretary-General David Cairns about a recent conversation he had had with FASB Chairman Beresford and Jim Leisenring about proposals for involving the FASB more in the work of the IASC. Among the proposals was one that "the FASB could appoint an observer to

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[22] See: WAR, March 1982, October 1982, and December 1983.

[23] See: WAR, September 1979, June 1983, and October 1984.

the IASC Board."

Before the World Congress of Accountants in Tokyo, October 11-15, 1987, the majority of the IASC Board did not take very seriously the possibility of inviting the FASB and the European Commission to serve as IASC observers. The non-US, non-UK members were quite conscious of the asymmetry of means and reputation between the FASB and the IASC at that time. For many IASC Board members, it would have been interpreted as giving too much influence to the US point of view. But those who favored the invitation were helped by the following: (1) the AICPA sent representatives to the IASC Board who held personal opinions that did not always coincide with GAAP; and (2) the European delegates, who had a blocking minority, kept referring to the [European Community's Accounting] Directives,[24] but held different national interpretations of them. "The situation was becoming embarrassing, as the exercise was not to invent, but to choose (or to offer options) between proven methods."[25]

At the Tokyo World Congress, outgoing IASC Chairman John L. Kirkpatrick and incoming Chairman Georges Barthès de Ruyter (Georges Barthès)[26] agreed that they would offer two observer seats to the FASB and the European Commission. "This was part of a very significant shift in policy lead by Georges Barthès. As soon as he became chairman, he emphasised the need for direct links between the IASC and important players: the FASB and the European Commission. He went to the FASB within two weeks of taking office."[27] Georges Barthès has observed:

> …we knew it would be easy with the FASB and very difficult with the Commission. But, politically, it had to be simultaneous. If not, the general feeling would have been that the IASC would become the international subsidiary of the FASB. Think of the difference of technical means between the two organisations! And it was already obvious that Europe would be a better "market opportunity," at first, than the US. So the move was de-

[24] Mainly the Fourth and Seventh Directives, which govern the contents of published financial statements.

[25] Georges Barthès de Ruyter, email to author, September 2, 2008. David Cairns, emails to author, September 11, and December 15, 2011, indicated that US and UK board members were likewise quite conscious of the assymetry of means and reputation between the FASB and the IASC at that time, but that all US and UK members "did not necessarily support inviting the FASB and the EC."

[26] WAR, January 1987.

[27] David Cairns, email to author, October 27, 2008.

layed by the incapacity of the Commission to decide…[28]

On October 26, 1987, Georges Barthès and David Cairns visited the FASB "in order to find ways of establishing a permanent link between the FASB and IASC." Cairns minutes indicated: Georges Barthès observed that he would like to involve both the FASB and the EC more directly and permanently in the work of IASC. Beresford supported the idea of involvement in the Consultative Group and suggested that it might be more cost effective for such a FASB person to stay on as an observer to the Board meetings. Involvement in IASC Steering Committees was also discussed. Ways of increasing IASC involvement in the work of the FASB were considered including IASC taking part in FASB task forces and making nominations to the Financial Accounting Standards Advisory Committee (FASAC).[29]

On March 11, 1988, Cairns visited the FASB for discussions regarding invitations to the Consultative Group, national standard-setter meetings, and IASC's Comparability Project. Cairns's notes indicate that he "confirmed that the Board would not decide until June 1988 whether to extend a formal invitation to the FASB [and the European Commission] to join the Consultative Group"; that the meeting participants thought that it was particularly appropriate that a national standard-setters meeting consider "the experience of standard-setting bodies with conceptual frameworks"; and that a general discussion took place on various technical aspects of IASC's Comparability Project, including pooling (uniting) of interests, investments, and joint ventures.

In the June 27, 1988, issue of *Status Report*, Beresford set forth his view of the role the FASB might take in achieving accounting standards responsive to the needs of a global marketplace.[30] Regarding the term *harmonization,* Beresford observed that it should not be seen as "a search for commonality at the price of settling on the lowest common denominator…[T]he FASB would support an objective that seeks to create superior international standards that would then gradually supplant national standards as the superior standards became universally accepted." Beresford identified a number of obstacles that needed

[28] Email to author, September 13, 2008.

[29] David Cairns, emails to author, October 27, 2008,and December 15, 2011. "The IASC made a nomination (Derek Bonham, the CFO of Hanson). I recall it being quite a difficult process to find somebody both suitable and available to participate in the US process."

[30] Remarks made to the IASC Board during its Toronto meeting, June 22-24, 1988, WAR, October 1988, p. 8. Venue confirmed by David Cairns, email to author, September 11, 2011.

to be overcome for international accounting standards to be widely accepted: (1) the differing national objectives of financial reporting; (2) the wide spectrum of national standard-setting structures from predominantly government-set to predominantly private-sector standards; (3) nationalism; and (4) the particular economic, political, and social priorities of various nations. After acknowledging the criticisms of the FASB's attitude toward IASs (variously described by others as "benign neglect," "uninterested," "uncooperative," and "less than enthusiastic"), Beresford identified a number of actions that should help the FASB become more directly involved in improving international accounting standards. The FASB's near-term international initiative included: (1) willingness to join the IASC Consultative Group; (2) expansion and strengthening relationships with national standard-setting bodies; (3) more systematic analysis of international accounting literature in connection with major FASB projects; (4) solicitation of more commentary on FASB exposure drafts from an international perspective; (5) discussion with IASC leadership on holding an international conference of national standard setters on accounting conceptual frameworks; and (6) seeking accountants with foreign experience to join the FASB staff. Beresford commented, "Injecting an international perspective into [the FASB's due] process can help make the FASB a constructive player in the quest for superior international standards that are universally accepted." He concluded, "International standards are not likely to be our highest priority for the foreseeable future but they will be a factor in our regular process. Their priority will rise as constituent needs increase…."[31]

On August 1, 1988, IASC Chairman Georges Barthès extended an invitation to Beresford to join the IASC Consultative Group. Sagely, he observed:

> The Board is well aware that improvements in International Accounting Standards cannot be separated from developments in national requirements. Closer working relationships between IASC and national standard-setting bodies will help increase the likelihood that different national standard-setting bodies reach the same solution to the same issues. Such a position is, without doubt, the best basis for International Accounting Standards.[32]

[31] "FASB Viewpoints: Internationalization of Accounting Standards: The Role of the Financial Accounting Standards Board," No. 195, pp. 3-6.

[32] IASC Archive File, FASB.

George Barthès noted the Board had decided to review its policy on the attendance of observers (notably, members from the Consultative Group) at Board meetings. Thus, he could not confirm whether the FASB representative would be able to attend part of the Board meetings on a regular basis.

Ten days later, Beresford responded to Georges Barthès's letter, "I believe we should defer a decision on accepting the invitation until you have concluded your discussions regarding attendance of observers at Board meetings." Noting that the FASB had to carefully consider costs and would have difficulty justifying sending someone to a one-day meeting overseas, he observed that "a major objective of our participation is to hear the discussion of the projects by the Board members themselves."[33]

Ultimately, on September 12, 1988, Georges Barthès wrote Beresford to extend the invitation for the FASB to attend Board meetings as well as Consultative Group meetings. In addition, he noted that a similar invitation had been extended to the European Commission. On September 27, Beresford accepted the IASC's invitation. FASB Board member James Leisenring was the initial appointee as FASB observer. *World Accounting Report* (October 1988) greeted FASB's acceptance of IASC Consultative Group Membership as "a major development indicating a move away from its previous insular perspective."

THE FASB SEEKS TO INVOLVE THE IASC

Rather quickly after accepting the IASC's invitation, the FASB sought to involve the IASC in its own projects. Thus, less than a month later, on October 21, 1988, Beresford wrote Georges Barthès asking him to nominate someone who could lend an international perspective to the FASB's task force looking into recognition and measurement phases of its project on Financial Instruments and Off-Balance Sheet Financing.

The FASB continued to press the IASC to hold a conference of national standard-setters on Conceptual Frameworks.[34] In conjunction with the 1990 United Nations meeting,[35] the FASB agreed to a formal IASC visit at which the IASC would report on

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[33] IASC Archive File, FASB.

[34] *Meetings at the FASB, Norwalk, Connecticut*, July 18, 1989.

[35] David Cairns, email to author, September 11, 2011. "It was 'in conjunction with' only in the sense that I and (probably) Georges Barthès were in New York for that meeting. In the same way that the FASB had cost constraints, the IASC also had budget constraints. As the relationship developed, the IASC made specific visits to the FASB unrelated to other commitments in the US."

what its Board intended for its Exposure Draft on Comparability (E32).

At the July 25, 1989, Financial Accounting Standards Advisory Committee meeting, E32 featured prominently in the discussions. In his notes on the meeting, David Cairns reported that among the issues were the question of implementation and the need for compromises that would not result in the weakening of national standards. Noting that IASs were well above the lowest common denominator, Cairns emphasized the important role national standard-setting bodies could play in IASC and the need for change in IASC itself. Further, he stressed that the comparability project was part of a wider improvements project that IASC was carrying out.[36]

In early 1991, the FASB's Financial Accounting Foundation (FAF) asked the FASB Board to prepare a strategic plan for FASB international activities. On March 5, David Mosso, former two-term Board member and current FASB senior staff person, faxed Arthur Wyatt, IASC Chairman, a copy of the draft strategic plan for his review. In his thoughtful comments welcoming FASB's development of a strategic plan for international involvement, Wyatt, an American and former FASB member, 1985-87, observed:

> …I believe that the ultimate resolution of the standard-setting dilemma internationally will not lie in the hands of the standard setters, but will lie in the hands of the regulators….
>
> …I believe that [the FASB] has gone too far in [the] direction [of the detailed rules approach] and that the most significant responsibility for fair financial presentations must rest with preparers and auditors. If such a development were to take place, accounting standards would have to be more flexible than they are in the United States and thus be somewhat more like those we find in many other countries. Greater flexibility, of course, poses real problems for regulators, but in my view the direction in which we have been moving in the United States is doomed to failure. There simply isn't any way for the FASB, or any other private sector standard-setting body, to bear the responsibility that is properly borne by those who prepare financial statements and those who audit them.[37]

[36] IASC Archive File, FASB.
[37] IASC Archive File, FASB.

Wyatt concluded that the IASC appeared to be a structure that had promise for achieving improvements over a shorter time span than other alternatives one could develop.

On March 12, 1991, Cairns met with FASB's Jim Leisenring, David Mosso, and Jeannot Blanchet (the person with international experience that the FASB recruited to deal with international matters)[38] to discuss FASB's draft strategic plan. Among the items discussed were FASB/IASC cooperation on earnings per share (EPS) and business combinations, annual meetings of national standard setters, and the effectiveness of FASB involvement in IASC's Consultative Group. Cairns's notes[39] record that "DHC [Cairns] recognized problem. Added that reconsidering role of Consultative Group – may need to move away from focus on IASC Board's current agenda." Subsequently, Cairns noted, "My acknowledgement of problems with consultative group meetings was a general concern that the IASC was not getting the sort of input it wanted from the consultative group." [40]

In August 1991, the FASB published its plan for international activities in its *Status Report*.[41] Paragraph 3 gave the two assumptions upon which the plan was based: domestic financial reporting needs would continue to be the FASB's first priority, and its international activities would be conducted within its charter and mission statement. Paragraph 4 reiterated the FASB's position that "[t]he ultimate goal…would be a body of superior international accounting standards that were accepted in all countries as GAAP for general purpose external financial statements." Paragraph 5 laid out the principal goals of the FASB's international strategy: (1) "[t]o make financial statements more useful for investor and creditor decision making by increasing the international comparability of accounting standards concurrently with improving the quality of accounting standards"; and (2) "[t]o enhance the FASB's standard-setting process, and resulting standards, by gaining new insights and ideas from other national and international standard setters and from financial statement users, preparers, auditors and educators in other countries."

[38] David Cairns, email to author, October 27, 2008.

[39] Notes of a meeting at the FASB, Norwalk, 12th March 1991, on the FASB's draft Strategic Plan for involvement in International Activities. IASC Archive File. FASB.

[40] David Cairns, email to author, October 27, 2008.

[41] Drafts of the FASB plan were discussed with the IASC, the FASAC, the technical partners of the Big Six accounting firms, representatives of the SEC, and the AICPA.

In paragraph 6, the FASB outlined the standard-setting efforts it would take to achieve these goals, including: (a) consideration of foreign national and IASC standards in domestically oriented FASB projects; (b) engagement in joint multinational standards-setting projects on mutually selected topics; (c) considering the adoption of foreign national or IASC standards judged to be superior to their US counterparts; (d) convincing other countries, or the IASC, to adopt specific US standards judged to be superior; (e) attempting to reach agreement on a choice of existing standards to which neither US standards nor other national or IASC standards were demonstrably superior; and (f) continuing to encourage equality of financial statement requirements for foreign and domestic companies in their utilization of US capital markets.

Paragraph 9 laid out the FASB's near-term focus: (1) cooperate with IASC, Canada, and other national standard setters in the consideration of accounting for financial instruments; (2) participate in an international conference on a common framework of accounting concepts; (3) review the differences between US standards and those of the IASC and other major countries; (4) identify a project with promise for reaching quickly broad international agreement, such as determining the EPS denominator; and (5) consider adopting IAS 20, Accounting for Government Grants.[42] *World Accounting Report* [October 1991, p. 1] greeted the plan by noting that "the FASB is set to become a major player in international harmonization, after 20 years of only occasional flirtations" with non-US standard setters and the IASC.

In the June 30, 1992, issue of *FASB Status Report*, Beresford recounted the progress the FASB had made in the implementation of its plan and its internationalization efforts. The FASB had amended its mission statement to add an international dimension, nearly a decade after former Board member Walters had commented upon it. It had formed an informal advisory group to advise it on international matters, and, over the previous two years, had systematically given more attention to the accounting and research studies of other countries. It supported the IASC in its efforts to harmonize accounting internationally, had sent detailed comment letters on various IASC Exposure Drafts, and had offered its assistance to the IASC on its agenda projects, such as earnings per share. In terms of its relations

[42] "FASB's Plan for International Activities," No. 223, August 31, 1991, pp. 6-8.

with other countries, Beresford reported that the FASB supported the "mutual recognition" thrust of the SEC, especially with respect to Canada and the United Kingdom. In addition, it had invited the representatives of selected countries to attend a meeting at its offices following the October 1992 World Congress of Accountants in Washington, D.C.[43]

Forty participants attended the two-day conference.[44] Among them were: David Cairns, IASC Secretary-General; Eiichi Shiratori, incoming IASC Chairman; Edouard Salustro, President of the Fédération des Experts Comptable Européens (FEE); John Hegarty, FEE Secretary-General; Karel Van Hulle, European Commission; and standard setters from Australia, Germany, Japan, and the United Kingdom. Items discussed included a review of the Brussels Conference on the need for a common conceptual framework, country-by-country reviews, cooperative efforts to improve accounting standards, and future meetings.[45]

On May 4, 1993, FASB Chairman Beresford and Canadian Accounting Standards Board (AcSB) Chairman Paul Palmer sent a joint letter to IASC Chairman Eiichi Shiratori to suggest that the IASC's recent decision to reconsider IAS 14, Business Segments, presented "an excellent opportunity" for the staffs of the IASC, FASB and AcSB "to share information and insights on the issues that will be addressed as these projects unfold." As a consequence of this cooperation, the IASC's revised IAS 14 (1997) was more similar to the FASB's original business segments standard than the revised FAS 131.[46] There would be future cases in which, despite collaboration, the FASB and international standard setters would arrive at different approaches.

In December 1994, Beresford reported that the FASB had undertaken an evaluation of its Strategic Plan for international activities, and had essentially reaffirmed it with some revisions. He noted that in the original plan the FASB had listed as one of

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[43] *Status Report*, No. 232, pp. 6 – 10.

[44] David Cairns, email to author, October 27, 2008: "It was this meeting which, to all effects, led to the creation of G4. Around this time, the FASB and the IASB also decided to co-operate on earnings per share. The IASC had already made significant progress and the FASB began the project on the basis that it would conform GAAP with the IASC's thinking, as the FASB made clear in its project proposal"

[45] "FASB Hosts Meeting of World Standard Setters," *FASB Status Report*, No. 237, November 30, 1992, pp. 2-3; for an interesting summary of the divisions evident at the meeting, see K. Atchley, 1992, pp. 154-155.

[46] David Cairns, email to author, September 11, 2011. "This is a view (perhaps a myth) which seems to have grown up during the last few years. At the time the revised IAS 14 was approved the message was that it was close to FAS 131." (See the history of IAS 14 in Cairns, 1999, pp. 741-744).

its focal points "to encourage the equality of financial statement requirements for foreign and domestic companies in their utilization of US capital markets." In the revised plan, this became a specific objective, rather than a broad area of interest. Beresford acknowledged that the movement toward international comparability should be comprehensive and that "the FASB should, where possible, contribute to the process at all levels." He reported further that the FASB had revised the premise that domestic financial reporting needs would continue to be its first priority and that of other national standard setters. In light of its experience, the FASB concluded that its obligation to its domestic constituents demanded "that it attempt to narrow the range of difference between US and foreign standards," working with other standard setters around the world "to the extent necessary to achieve greater comparability."[47]

THE IASC/IOSCO CORE STANDARDS PROGRAM[48]

As noted above, the IASC had been criticized for years for standards that were said to approach the lowest common denominator. The first attempt to address such criticism, its Comparability/Improvements projects, had met with only limited success.

In the course of IASC's history, one of its most important external relationships was that with the International Organization of Securities Commissions (IOSCO). The relationship had begun in 1986, and a close liaison had developed during the Comparability/Improvements projects (1987-1994). With the passage of time, each organization devoted more and more time and resources to advancing their common cause: the issuance by IASC and endorsement by IOSCO of a core set of IASs that could be employed to prepare the necessary financial reports for cross-border listing of corporate securities. When the completion of the Comparability/Improvements projects in 1993 did not result in IOSCO endorsement, the executive officers and Board of IASC had been collectively very disappointed, and relations between IOSCO and IASC Chairman Shiratori became strained.[49]

[47] "Notes from the Chairman," FASB Status Report, No. 259, p. 2.; and "Highlights of Financial Reporting Issues: FASB's Plan for International Activities," FASB Status Report , No. 262, pp. 6 – 10.

[48] Excerpted from Kirsch, 2006, various chapters, updated with further research.

[49] David Cairns, email to author, September 11, 2011. "There were a lot of

There was clear evidence that the FASB was critical of aspects of the IASC's approach to meeting IOSCO's requirements in terms of both technical content and due process [Camfferman and Zeff, 2007, pp. 338-340]. During Cairns's time as Secretary-General, there was tension between the views of the IOSCO representatives on the Improvements Project and the comments of the FASB. His last two years saw evidence of tensions between the position of the FASB and that of the US Board representatives on financial instruments. Cairns recalled occasions "on which the FASB observers openly criticised US [Board] representatives for supporting certain positions."[50]

On July 5, 1995, the newly appointed IASC Secretary General, Sir Bryan Carsberg, informed Shiratori that IOSCO had responded with enthusiasm to the IASC's draft revised work program, and that IOSCO had prepared a draft press release stating that the proposed wording seemed "very helpful." As a result, on July 9 the Board of the IASC and the Technical Committee of IOSCO issued the following joint press release:

> The [IASC] Board has developed a work plan that the [IOSCO] Technical Committee agrees will result, upon successful completion, in IAS comprising a comprehensive core set of standards. Completion of comprehensive core standards that are acceptable to the Technical Committee will allow the Technical Committee to recommend endorsement of IAS for cross border capital raising and listing purposes in all global markets. IOSCO has already endorsed IAS 7, Cash Flow Statements, and has indicated to the IASC that 14 of the existing International Accounting Standards do not require additional improvement, providing that the other core standards are successfully completed.

The press release was greeted with a measure of caution by IASC. The October 30, 1995, minutes of the Executive Committee reported that the wording of the agreement with IOSCO was such that IOSCO would not have to make a firm commitment to endorse IASs even after satisfactory completion of IASC's work program. Nevertheless, the general view was that it would be difficult for IOSCO not to endorse international standards

IOSCO people who agreed with what ES [Eiichi Shiratori] said – the problem was the SEC both from the perspective of the IASC and other members of IOSCO."

[50] David Cairns, email to author, October 27, 2008. "Following the July 1995 agreement [between the IASC and the IOSCO Technical Committee], there were some very strong criticisms by the FASB about the IASC's approach to completion of core standards."

upon successful completion of the IASC work program because of the way IOSCO had raised public expectations. As Martinez-Diaz [2005, p.11] has noted, "it was widely understood that the rejection of [the Core Standards] by the IOSCO—and by its most powerful member, the SEC—would severely limit the future of IASC standards."

While far from perfect, the IASC/IOSCO press release would be referred to by both organizations in the years ahead as proof of their good intentions and as a rationale for the steps they would take. It would prove to be a defining document in their long-running collaboration.[51]

There was division within IOSCO about the course it should take. Should it endorse the IASC's standard-setting process, or should it endorse standards one by one? Should it demand the completion of the whole body of minimum International Accounting Standards? And, should it insist upon the establishment of an IASC interpretation mechanism?

On July 12, 1995, three days following issuance of the IASC/IOSCO joint press release announcing the Core Standards Program, and shortly before the FASB notified the SEC of its intention to undertake a comparative study of US and IASC Standards, FASB Chairman Beresford sent Carsberg a copy of a draft of a letter to the SEC for his review and comment. In the draft letter, Beresford noted that "[t]he IASC improvements project has narrowed the range of differences from US GAAP, but many differences remain, even in the newly adopted standards."[52] On July 20, Carsberg responded that he hoped the IASC could be involved in the project "by seeing drafts at an early stage and having the opportunity to comment on them," and that he would like to see the findings feed into mutual efforts to eliminate or at least narrow the differences. Once the FASB comparison project was completed, Carsberg wrote Beresford, "our standards are being revised [in connection with the Core Standards Program] and we shall certainly be considering your catalogue of differing requirements in making decisions about our revisions."[53]

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[51] "Put at its most basic, the new end game involves IASC moving its standards near enough to US GAAP to be acceptable to the SEC as providing equivalent transparency and thereby shareholder protection, while at the same time staying far enough away from GAAP to win the support of the rest of the world." WAR, August/September 1995, p. 1.

[52] IASC Archive File. Chairman, Secretary-General Correspondence.

[53] In late 1996, Beresford noted that the SEC might consider IASC standards for use without reconciliation to GAAP by foreign companies in US capital markets as early as 1998. Beresford commented: "Using IASC standards without

In an April 11, 1996, press release, the SEC indicated that it supported the IASC's objective "to develop…accounting standards that could be used for preparing financial statements used in cross-border offerings." It noted that there were three key elements to the IASC's program and the SEC's acceptance of the results: (1) a core set of comprehensive, generally accepted accounting pronouncements; (2) high quality standards resulting in comparability, transparency, and full disclosure; and (3) rigorously interpreted and applied standards. Once the IASC had completed its Core Standards Project, fulfilling these key elements, it was the Commission's intention "to consider allowing the utilization of the resulting standards by foreign issuers offering securities in the US." Thus, the SEC did not agree automatically to accept the IASC's core body of standards, but expressed its "intention to consider" them [Kirsch 2006, p. 301].

IASC and IOSCO progress on the Core Standards Programme presented interesting challenges to the SEC (the strongest IOSCO member) and the FASB. They were confronted with deciding whether and how the SEC should endorse IASs, as well as contemplating the role of the FASB following that endorsement. On March 27, 1997, FASB Chairman Beresford minuted a recent Financial Accounting Foundation (FAF) meeting with the SEC. Those minutes make it clear that in early 1997 SEC Chairman Levitt was unsure which position the Commission should take in endorsing IASC's core standards, an incremental approach or a total package approach. It is also clear that Levitt was interested in preserving the FASB as a standard setter while supporting the internationalization of accounting standards, that the FAF and the FASB were interested in seeing the IASC improve all its standards, and that there was dissatisfaction with some public statements made by IASC's leaders.

In February 2000, the SEC issued *Concept Release: International Accounting Standards*[54] to request input on "whether the

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reconciliation to US GAAP would shift the burden to US investors attempting to compare investment opportunities among foreign and domestic companies competing for capital on the same market. The FASB's comparison Report can help those investors sort out the differences," in FASB Status Report, No. 168C, December 23, 1996, p. 1.

[54] As early as September 2, 1998, Paul Leder (SEC and IOSCO Working Party No. 1 Chairman) and Mary Tokar (SEC) briefed Sir Bryan Carsberg in London. On September 28, 1998, Carsberg wrote a memorandum to the Executive Committee members to outline their proposals: "…SEC would start its processes in the United States by issuing a "Concepts Release" [sic] before taking a position on endorsement in IOSCO fora. Publication of the Concepts Release would show continuing momentum and determination to move ahead with decisions….then,

IASC standards: 1. constitute a comprehensive, generally accepted basis of accounting; 2. are of high quality; and 3. can be rigorously interpreted and applied." The SEC received 93 comment letters ranging from statements indicating that IASs were principles of high quality requiring no reconciliation to GAAP to the opposite extreme that they were of lesser quality requiring full reconciliation. US commentators generally fell into the GAAP rule-based/reconciliation group; non-US commentators more often fell into the principles-based group.[55]

Following analysis of the comment letters received in connection with the concept release, the SEC continued to monitor international accounting standard-setting developments. There was a change in the Commission's leadership following the SEC's receipt and analysis of its February 2000 Concept Release. Arthur Levitt departed and was replaced by Harvey Pitt, who was shortly replaced by Christopher Cox. The SEC's position on IASs was in limbo for quite a while. Finally, in October 2002 the SEC supported the FASB/IASB Norwalk Agreement formalizing their commitment to the convergence of GAAP and international accounting standards (see below).

THE G4+1[56]

In the early 1990s, a powerful grouping had come into operation: the G4+1. Sir David Tweedie, IASB Chairman, recalled that it "started accidentally" when, in his capacity as Chairman of the UK's Accounting Standards Board, he had a meeting with FASB Chairman Beresford in which the two of them agreed it would be a good idea to set up a joint group. Street [2005, p. 10] described the meeting as occurring at the FASB's Norwalk office in 1992; John Denman, Accounting Standards Director of Canada's Accounting Standards Board (AcSB), joined the discussion and the three agreed to work together—hence, in Tweedie's view, taking the first step in the development of the "Group of 4." Originally, the standard setters of Australia, Canada, the United

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if things were still looking positive, a detailed rulemaking proposal in the United States to meet the formal requirements for moving to accept our Standards for cross-border listings."

[55] The 48 comment letters that were filed electronically are available at www.sec.gov/rules/s70400.htm; hard copies of all comment letters are available in the SEC's Public Reference Room, File No. S7-04-00. For IASC's analysis of the comment letters, see: "Mixed Views on IASC Standards," IASC Insight, June 2000, pp. 12-13.

[56] Excerpted from Kirsch, Chapter 8, and updated with further research.

Kingdom, and the United States (the G4) sent representatives,[57] and IASC members were invited to participate as observers (G4+1). The group met several times each year and progressed from background studies to "position papers" that could have been used to prepare exposure drafts. Turf wars developed as both IASC and some G4 representatives entertained global accounting visions. Some G4 members began to ponder possible alternatives to IASC. Among those considered were G4, an expanded G4, or an expanded FASB [WAR, May 1996, p. 1].

IASC Chairman Michael Sharpe (1995-97) and Secretary-General Carsberg, recognizing the way the wind was blowing, advocated restructuring the IASC so that it would become a quality international accounting standards setter. They succeeded in convincing the IASC to appoint the Strategy Working Party (SWP). Once that was formed, the agenda of G4+1 meetings included a discussion of IASC's restructuring [Street 2005, pp. 65-67].

For its part, the IASC was closely interested in the work of the G4+1 from its beginning in early 1993, following the discussions at the FASB in 1992.[58] On January 30, 1996, Members of the Executive Committee discussed the role of G4+1 and its relationship with IASC. Carsberg saw it "as an important challenge in communication to build up relationships with standard setters in other countries so that the G4 countries would not be seen as excessively influential."[59]

The Executive Committee meeting minutes show a continual interest in the G4+1, including its work on financial instruments,[60] pooling accounting,[61] performance reporting,[62] and share-based payments.[63] The IASC participated in G4+1

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[57] Street [2005, pp. 10 and 13-14] indicated that G4 was not intended to be an "Anglo-American club." All countries with an accounting standard-setting body were extended an invitation to join. However, only the G4 standard setters self-selected. Street cites Jim Leisenring's explanation that this was due to their interest in international financial reporting and their desire to solve accounting problems using the IASC Framework's concepts. Street reported that Herman Marseille of NIvRA, the Dutch standard setter, attended one G4+1 meeting, but NIvRA decided not to join due primarily to resource constraints and the fact that its Board members were part-time.

[58] David Cairns, email to the author, September 11, 2011.

[59] Executive Committee, January 30, 1996.

[60] Paris, October 29, 1997.

[61] Niagara-on-the-Lake, Canada, July 5, 1998.

[62] Zurich, November 8, 1998, Washington D.C., March 15, 1999, and Venice, November 14, 1999.

[63] Executive Committee, Copenhagen on June 18, 2000.

discussions, issued G4+1 discussion papers with its own wrap-around covers,[64] and re-opened existing standards or initiated new ones. Michael Sharpe has noted that the G4+1 was very helpful to the IASC. There was a risk, however, that unless the IASC got its own act together, G4+1 could develop a life of its own.[65]

RESTRUCTURING THE IASC[66]

A number of internal and external factors triggered the recognition by IASC Chairman Sharpe and Secretary-General Carsberg that the IASC needed to consider its future mission and structure once the IASC/IOSCO Work Programme had been completed. One need was to improve relations with national standard setters to realize a "complete harmonisation between international standards and standards used for domestic reporting." This could be achieved, on the one hand, through "working with governments and governmental agencies to encourage official adoption of international standards" and, on the other, "[w]orking with national standard setters to co-ordinate agendas and attempt to agree common solutions." Another factor for considering the IASC's future mission and structure was a desire to enhance the global representativeness of the Board by enlarging its country membership seats.[67]

Before the Executive Committee meeting in June 1996 Carsberg released an agenda paper, *Future Strategy of IASC*,[68] for the Executive Committee and Advisory Council to discuss at their forthcoming joint meeting. That meeting[69] was the scene of a lively debate, after which the participants agreed that Carsberg should draft terms of reference for a working party to consider the future strategy of the IASC.

June 1996 was an eventful month for the IASC. In addition to its joint Executive Committee and Advisory Council meetings, it participated in the World Standards Setters meeting. On June 21, FASB Chairman Beresford delivered a series of eight

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[64] David Cairns, email to author, September 11, 2011. "[O]nly the covers ...were different – the same happened in each G4 country."

[65] Michael Sharpe, email to author, March 22, 2004. At its 2001meeting in London, given the imminent commencement of the IASB, the G4+1 decided to disband and cancel its future activities. G4+1 COMMUNIQUÉ, Number 10, January 2001.

[66] Excerpted from Kirsch [2006, Chapter 10], and updated with further research.

[67] *Plans for IASC*, Advisory Council Papers – July 1995, Agenda Paper IV.

[68] Executive Committee Papers – June 1996, Agenda Paper X.

[69] Executive Committee and Advisory Council, Frankfurt, June 9, 1996.

suggestions for IASC procedural changes to reinforce the IASC's importance in the internationalization of accounting: (1) hold meetings open to the public; (2) consider additional procedures, such as public hearings on proposals and field testing, to ensure that it received and considered the best possible input; (3) better educate its members on the intricacies of matters under consideration; (4) send materials to Board members "well in advance" of meetings (some Board members complained they had too little time to consider them) for careful analysis by home country associates and for development of carefully reasoned positions; (5) greatly increase the size of its staff to do the technical support work for its steering committees; (6) resolve the matter of implementation guidance for IASs; (7) find a way to "reduce the inherent conflict of interest when an all-part-time Board sets standards its own members must follow and audit"; and (8) be realistic in its work plans and commitments to develop a complete set of IASs. Beresford felt it was "highly unrealistic" to expect to complete the Core Standards Programme by March 1998.[70] Many of his suggestions were implemented by the IASC/IASB, including open public meetings, implementation guidance with the creation of the interpretations committee, IASB's greatly increased staff compared to IASC's, and elimination of the "inherent conflict of interest" with the introduction of the largely full-time IASB. In the coming years, Beresford's public comments were repeated and elaborated upon in public and private by the FASB and SEC members who participated, officially and unofficially, in the work of the IASC's Strategy Working Party.

THE STRATEGY WORKING PARTY[71]

At the September 1996 Executive Committee meeting, Carsberg introduced an agenda paper[72] that presented his proposal for the establishment of a Strategy Working Party (SWP). The Executive Committee and the Board approved the SWP's terms of reference. IASC Chairman Sharpe and Secretary-General Carsberg asked Ed Waitzer, a lawyer and former Chairman of

[70] Dennis R. Beresford, "Outline: World Standards Setters." Beresford sent the outline of his remarks to the 1996 World Standard Setters meeting to the author with a letter dated August 11, 2008. See also: Jim Kelly, "IASC/IOSCO—A Hand on the Brake," WAR, April 1997, p. 2.

[71] Exerpted from Kirsch [2006, Chapter 10], and updated with further research.

[72] *Strategy Working Party*. Executive Committee Papers, Agenda Paper VI.

the Ontario Securities Commission and of the IOSCO Technical Committee, to become chairman of the SWP, and he accepted. In August 2001, Carsberg commented, "[W]e felt pretty sure that Ed Waitzer…was somebody in good standing with the SEC… who could go to the SEC and talk about things and at the same time be well received there but take a somewhat independent view."[73]

At the SWP's first meeting on July 21-22, 1998, in London, Carsberg described the IASC's core standards agreement with IOSCO and the SEC's response. Former SEC Chairman David Ruder then discussed the likelihood that the SEC would accept the IASC's core standards once they were completed. Ruder emphasized that "the SEC will act cautiously and wish to retain oversight authority over the setting of accounting standards used in the securities market." During this meeting, the SWP began to use the term "convergence," which ultimately came to supplant "harmonization" in the IASC's deliberations and publications [Camfferman and Zeff, 2007, pp. 450-454].

The European Commission expressed support for a large (27-member), geographically representative part-time Board, with a full-time Chairman. The SEC supported a FASB-like full-time Board with at least seven technically expert members. SEC Chief Accountant Lynn Turner played an important role in pushing the SEC's position, often behind the scenes.[74] G. Michael Crooch, Arthur Andersen Partner and IASC Executive Committee member, knew Turner and talked with him frequently about strategy.[75] FASB Chairman Edmund Jenkins likewise worked behind the scenes to encourage the IASC's restructuring.[76] Key G4 players favored a full-time, small, independent international board with technical expert members; any other model would result in the G4 pursuing an alternative solution [Street 2005, pp. 73-76].

Secretary-General Carsberg quickly came to support the SEC's position; his Chairman, Stig Enevoldsen, had to be convinced to abandon the European preferred model. In the end, Enevoldsen came to support the full-time Board, provided it had some part-time members to represent real world thinking on current business developments.[77]

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[73] Sir Bryan Carsberg, interview, August 2001.

[74] Michael Sharpe, email to author, July 1, 2004.

[75] G. Michael Croché, interview, March 19, 2007.

[76] Edmond Jenkins, letter to author, September 14, 2008..

[77] Sir David Tweedie, IASB Chairman, and former Strategy Working Party member, interviews, January 9 and 15, January 2002. Confirmed by G. Michael

Enevoldsen and Carsberg had visited several European countries, Japan, and the United States. They participated in discussions at SWP, at the May and November meetings of the International Federation of Accountants (IFAC) Council, at meetings of G4+1 standard setters, and at the G10 Group of professional accounting bodies. They had several meetings with the Chief Accountant of the SEC and with the EC Director General of DG XV, the EU's Directorate for Financial and Company Law. The details of their unicameral model had been developed during these meetings. They hoped

> that the SEC will support the recommended model. We believe that it has the main features which the SEC sees as essential to an acceptable international standard setter. ...The FASB appears to have the same views as the SEC.[78] The SEC has threatened to encourage this [formation of a competing standard-setting body] if it is not satisfied with our proposals.…Board members will wish to consider the probability of formation of a competing body and its consequences for IASC.

Regarding the European Commission:

> The European Commission holds a different view of the preferred IASC structure from that of the SEC.... Board members will wish to assess the risk of loss of support for IAS in Europe following adoption of the recommended model and, in doing so, will consider the significance of the fact that many European companies in practice can use US GAAP for their group accounts at present.

At this point, Michael Crooch (then US IASC Board representative for the AICPA who later succeeded James Leisenring on the FASB) began some extensive telephone diplomacy with the SEC and the SWP Chairman. A detailed compromise was put together on which the SEC was willing to issue a supportive press release. However, this meant that the IASC Board was un-

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Crooch, former IASC Executive Committee member, who noted that Enevoldsen and Carsberg had independent views. Because both wanted high-quality international accounting standards, and they disagreed about the appropriate organizational model; this was a difficult time for both of them. Interview of Crooch, March 19, 2007.

[78] Stig Enevoldsen, interview, June 20, 2003, indicated that the G4 put tremendous pressure on Carsberg and him, reminding them that they could create their own standard setter. Also, the FASB put tremendous pressure on the IASC, threatening to become the international standard setter. However, Enevoldsen observed, "The IASC had the brand."

able to change anything of significance. Nevertheless, the Board unanimously supported the proposed structure at its November 15-19, 1999, meeting in Venice.

Anthony T. Cope,[79] FASB member and observer at the IASC Board who served on the IASC's Strategy Working Party along with Financial Accounting Foundation Trustee David Ruder, wrote in late 1999: "The FASB is pleased that the IASC Board has accepted the recommendation of its Strategy Working Party to restructure."[80] Cope had good reason to be pleased. He and Ruder had held out successfully for a small, independent international standard-setting board. They were aided by the fact that there were also a few "non-Anglo-Saxons" on the SWP who accepted what their "Anglo-Saxon" friends were proposing. The EC had been contesting the bid by the SEC to have more influence on international standard setting. However, an uncompromising EC letter convinced the SWP that it could not accept the EC's demands, and its decisions were unanimous.[81]

Cope recalled that at the IASC Board meeting (November 15-19, 1999) in Venice, where the Board approved the new structure and constitution, Michael Crooch made the presentation; there were many trans-Atlantic calls during the course of the meeting. The Executive Committee could announce at the meeting that the SEC approved, while Cope could say the FASB supported the deal.[82] At its December 1999 meeting, the IASC Board voted unanimously to appoint the members of the Nominating Committee to select the initial trustees to implement the proposed new structure. The European Commission was not represented, nor was there a Japanese member.

In a January 13, 2000, news release,[83] the Nominating Committee announced that it had had its first meeting and initiated

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[79] IASC Chairman Michael Sharpe invited Anthony Cope to serve on the Strategy Working Party. Cope, a non-accountant, felt that he represented users of accounts and the interests of the global capital markets rather than the FASB specifically. He saw himself as a strong voice for a small, independent board. Interview, September 9, 2007.

[80] "FASB Supports Proposed New Structure for IASC Board," *FASB Status Report*, No. 204C, December 17, 1999, pp. 2-3.

[81] Georges Barthès de Ruyter, email to author, September 2, 2008.

[82] Anthony Cope, September 9, 2007. Michael Crooch, interview, March 19, 2007, reported that IASC Chairman Tom Jones had asked him to make the presentation; at the time, Crooch wondered whether it was a good idea for an American to make the presentation since some Board members were concerned with the amount of US influence. Former SEC Chief Accountant Lynn Turner confirmed these details, telephone interview, April 9, 2009.

[83] IASC Electronic Archives.

its search and selection process for the nineteen trustees of the restructured IASC. SEC Commissioner Arthur Levitt was named chairman of the Nominating Committee. That first meeting was held in Levitt's Conference Room at the SEC. At its second meeting, held in France, the SEC indicated its interest in recruiting well-known and highly qualified people to the IASCF Trustees. Levitt agreed to recruit Paul Volcker, who subsequently agreed to chair the Trustees.

The meeting of the member bodies of IASC occurred on May 24, 2000, in Edinburgh, Scotland. Enevoldsen urged the member bodies to support the creation of the new structure. The Assembly voted unanimously in favor of the recommendation for the adoption of the new constitution.[84] The trustees established two subcommittees, one to develop plans for assured and adequate financing, and a second to oversee the process of selecting board members.[85] A June 29 press release reported that the Trustees unanimously agreed that Sir David Tweedie, UK Accounting Standards Board Chairman, should become IASB Chairman.

The trustees' nominating committee[86] held interviews for new board members in 2000, which Sir David Tweedie observed. The trustees announced the names of the new board on January 25, 2001;[87] Table 3 lists their names and characteristics. That the basis of selection of new Board members was technical expertise is clear. Eight of the fourteen members were either representatives[88] or observer members[89] of the old Board, yielding significant continuity. David Tweedie, IASB Chairman, has commented that "a key feature of the [IASB] was the number who came from a standard-setting background. The Board had to be able to punch at the same weight as the FASB and, therefore, couldn't afford to have a steep learning curve in front of it."[90]

Having generated donation commitments of more than

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[84] Minutes of the Ordinary Meeting of the Assembly of Member Bodies of the International Accounting Standards Committee, May 24, 2000, Edinburgh.

[85] Press Release*: Shaping IASC for the Future: First Meeting of IASC Trustees and Appointment of New IASC Board Chair,* June 29, 2000. IASC electronic archives.

[86] Chaired by Ken Spencer, trustee and Australian representative on the old Board.

[87] Press Release: *IASC Trustees Announce New Standard-setting Board to Reach Goal of Global Accounting Standards*.

[88] Jones, Gélard, McGregor, Schmidt, Tweedie, Yamada.

[89] Cope, Leisenring.

[90] Email to author, August 14, 2008.

$75 million over five years, on March 15, 2001, the Trustees announced they had activated the new constitution. FASB Chairman Jenkins, on the formal implementation of the IASB, stated, "It is a critical and welcome event in establishing an independent global standard setter to provide high-quality financial reporting standards to serve our global markets."[91]

Table 3.

Characteristics of the New IASB Board Members

Former IASC Board

Name	**Country***	**Member or Observer**	**Liaison**	**Classification**
Sir David Tweedie	UK	Yes	No	Academic/Std. Setter
Thomas E. Jones	UK/USA	Yes	No	Analyst
Mary E. Barth – PT	USA	No	No	Auditor/Academic
Hans-Georg Bruns	Germany	No	Yes	Preparer
Anthony T. Cope	UK/USA	Yes	No	Analyst
Robert P. Garnet	S. Africa	Yes	No	Preparer/Analyst
Gilbert Gélard	France	Yes	Yes	Auditor/Preparer
Robert H. Herz - PT	USA/UK	No	No	Auditor
James Leisenring	USA	Yes	Yes	Standard setter
Warren McGregor	Australia	No	Yes	Standard setter
Patricia O'Malley	Canada	No	Yes	Standard setter
Harry K. Schmid‡	Switzerland	Yes	No	Preparer
Geoffrey Whittington	UK	No	Yes	Academic/Std. Setter
Tatsumi Yamada	Japan	Yes	Yes	Auditor

PT = part time.
*The first country is the country of birth; the second country indicates the Board member had many years of professional service there.

The first three months of 2001 were taken up with efforts to wind down the old IASC and to get the new IASC Foundation and its Board up and running. In February 2001, a get-acquainted meeting for the new Board was held. Robert Herz, then part-time IASB Member and later FASB Chair, attended that meeting, and recalls that the Board Members discussed the objectives of the IASB. They agreed that the IASB's goal would be to adopt a single set of high-quality international financial reporting standards.[92]

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[91] "FASB Supports IASB's Efforts," *FASB Status Report*, No. 217B, February 28, 2001, pp. 1 and 3.

[92] Interview, March 19, 2007.

THE FASB IASB CONVERGENCE PROGRAM

In the early days of its life, the IASB had elaborate protocols for dealing with national standards setters; the FASB was just one of many national standard setters. Over time, however, the working relationships between the two Boards evolved to the point at which, by 2007, most of the major standards projects were joint efforts of both.[93] In January 2002, IASB Chairman Tweedie indicated that he saw the IASB's two main objectives as (1) convergence of US and international standards and (2) the IASB's Improvements Project. Regarding convergence, Tweedie observed, "We must converge—not just adopt GAAP." He noted that at that point the IASB was involved in joint projects with the standard setters of the UK (Performance Reporting), the US (Business Combinations), and France (First Time Application). He also observed that, regarding the IASB's own Improvements Project, the Board was addressing IOSCO's concerns about the Core Standards. The IASB would be "ripping apart" 14 standards with the goal of arriving at a much better set of Core Standards by the end of 2002. Tweedie made it very clear that his objective was a single set of high-quality global accounting standards, at least as good as GAAP, and better whenever possible.[94] In a follow-up interview, he observed, "Convergence does not mean moving to the US standard; it means both of us [the IASB and the FASB] changing." When asked whether he thought the SEC would ever endorse the Core Standards and eliminate the reconciliation requirement, Tweedie replied:

> We are picking off the convergence issues. We have done all the big reconciliation issues already. So, the more we can move those two together over the next 2 or 3 years, reconciliation gains irrelevance....That, I think, will solve the problem for them [the SEC].[95]

Edmund Jenkins, the FASB's fourth Chairman, succeeded Beresford on July 1, 1997. His term saw growing demands for cross-border listings, escalating competition among stock markets, financial crisis in Asia—all forces pushing the demand for international accounting standards [Martinez-Diaz 2005, pp.12-14]. Jenkins had to deal with US accounting scandals, such as

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[93] Sue Bielstein, FASB Director of Major Projects and Technical Activities, interview, March 19, 2007.

[94] Interview, January 9, 2002.

[95] Interview, January 15, 2002.

Enron,[96] which induced many Americans to examine the rules-based/principles-based debate and look at IASs with new eyes [Eaton 2005, pp. 7-11].

Like his predecessor, Jenkins was an internationalist. He was FASB Chairman in 1999 when the Board issued jointly with the Financial Accounting Foundation (FAF) an important booklet, "International Accounting Standard Setting: A Vision for the Future." The report's stated objective was: "[To] discuss… how the FASB's role may continue to evolve and how its structure and process may change over time in the context of the FASB's objective and goals for participating in the international accounting system of the future."[97] "The timing of this report, during the final deliberations in the IASC over its proposed structure, suggests…an attempt to apply pressure to the IASC to restructure along the lines that were agreeable to FASB" [Eaton 2005, pp. 6-7].

Jenkins and the FASB paid close attention to international accounting developments and actively participated in them. Jenkins wrote the author as follows:

> The FASB's involvement and leadership in the G4+1's efforts to improve the IASC, the work of the SWP, and the final efforts to convince the IASC to change itself into the IASB were crucial to the success of those efforts. [T]here was strong support from others: Australia (Ken Spencer); the UK (David Tweedie); France (Georges Barthès), but it was Tony Cope, Mike Crooch and David Ruder—with Lynn Turner [SEC Chief Accountant] and me working behind the scenes—who made it happen in 2001.[98]

Jenkins's successor was Robert H. Herz, a former part-time member of the IASB and Senior Technical Partner of PricewaterhouseCoopers. Coming straight from the IASB, Herz assumed the helm of the FASB in July 2002—a time of great challenge to that standard-setting body due to the many accounting scandals of the late 1990s/early 2000s, passage of the Sarbanes-Oxley Act of 2002, SEC activism, and the establishment of the Public Companies Accounting Oversight Board (PCAOB). During Herz's chairmanship, SEC activism in international accounting issues

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[96] Tweedie noted to the author that Enron had not hurt the IASB. It had actually made people in the US more receptive to international accounting standards. Interview, January 15, 2002.

[97] Introduction, p. vii.

[98] Letter to author, September 14, 2008.

was heightened as it interacted with the FASB and the IASB, eased reconciliation and listing requirements for IASB compliant filers, and the like.

The FASB would experience a shift in emphasis to greater commitment to and involvement in international convergence activities under Herz's leadership. Ed Jenkins reminded the author, "[I]nternational activities at the FASB picked up in the later part of 2002 [at] the time Bob Herz became chairman of the FASB….[T]he newly restructured IASB was then in a position for the first time to work constructively on convergence issues." Herz had a strong international interest and background;[99] gradually, he moved the FASB in the direction of closer cooperation with the IASB. On the FASB Board, Herz indicated that all six of his Board colleagues supported convergence. He noted that Board members G. Michael Crooch, Katherine A. Schipper, and Gary S. Schieneman all had experience in the international arena. And he mentioned that on the IASB Board he could not recall a member who did not support convergence. Thus, on both sides of the Atlantic people were in place to assist the rapprochement of the two Boards.

In the summer of 2002, Herz convened meetings at the FASB to develop action plans, including one on convergence which ultimately led to the Norwalk Agreement later that year. Herz and Tweedie got along very well together. Herz commented, "Maybe we are like-minded. We are both Chartered Accountants." The two men were in weekly contact by telephone, and email. Herz estimated that in 2006, as a result of their attending conferences, joint FASB/IASB meetings, and other meetings, they met each other about 15 times per year.[100]

In his August 2002 "Chairman's Notes," Herz mentioned that the FASB met with members of the IASB and representatives of the SEC's Office of the Chief Accountant to discuss undertaking a project to accelerate international convergence by seeking to eliminate some of the existing areas of difference between GAAP and IASs."[101]

Joint meetings were an effective way for the two Boards to discuss major issues and reach common views. However, such meetings required significant preparation. The Boards met twice

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[99] Herz spent his teenage years in Argentina, studied and worked in the UK where he became a Chartered Accountant, and worked on PricewaterhouseCoopers' Global and US boards. Interview, March 19, 2007.

[100] Interview, March 19, 2007.

[101] *Financial Accounting Series No. 235: The FASB Report,* August 30, 2002, p. 2.

a year: at the IASB, London, in April, and at the FASB, Norwalk, Connecticut, in October. Senior staff members met and put together a proposed agenda that was reviewed by both Boards. Chairmanship of the meeting was shared between FASB's Herz and IASB's Tweedie.[102] There were 21 members at joint meetings: seven FASB members[103] and fourteen IASB members.[104] Although the Boards were meeting together, each one voted separately on each issue. That is, a proposal was accepted only if it achieved the required majority support of each Board.[105]

On September 18, 2002, the IASB held a joint meeting with the FASB at its headquarters in Norwalk. The main purpose of the meeting was to discuss projects that the two Boards were already working on jointly or would address jointly in the future in order to increase the international comparability of financial reporting. Prior to the meeting, the staffs of both Boards developed a proposed scope for the Short-Term Convergence Project.[106] Following that meeting, on October 2, the FASB added a

[102] Robert Herz, interview, March 19, 2007.

[103] As of July 1, 2008, FASB had only five members. The voting requirements were 3-2, a simple majority. The FASB Chair had decision-making authority to set the FASB's technical agenda. The FAF observed that the Chair's technical agenda setting authority would give the FASB "the ability to initiate and more quickly respond to pressing issues….This has the added benefit of further facilitating and improving the interface with the International Accounting Standards Board (IASB)." See Financial Accounting Foundation, "Request for Comments on Proposed Changes to Oversight, Structure, and Operations of the FAF, FASB, and GASB," December 18, 2007, pp. 4-5.

[104] The IASCF Trustees, in their second five-yearly constitutional review, proposed expanding the size of the IASB to 16 members effective January 1, 2010. While the IASCF Trustees believed that the Constitution's "emphasis on 'professional competence and practical experience' should remain paramount," their Proposal for Change made explicit a geographical component to Board membership with (a) four from Asia/Oceania; (b) four from Europe; (c) four from North America; (d) one from Africa; (e) one from South America; and (f) two appointed from any area, subject to maintaining overall geographical balance. With the growing number of countries adopting IFRSs, the Trustees determined to amend the Constitution with respect to the Board's size and geographical diversity. Thus, paradoxically, the Trustees returned to the geographical representation idea of the Strategy Working Party's bicameral model. On January 29, 2009, the Trustees issued a press release to announce amendments to the IASCF Constitution to: establish a link to a Monitoring Board of public authorities; expand the IASB from 14 to 16 members by 2012 while ensuring geographical diversity; enhance liaison with investor groups; directly address G20 recommendations; and provide free core standards through its public website.

[105] J. Michael Crooch, interview, March 19, 2007.

[106] "FASB-IASB Joint Meeting Supports Convergence," *Financial Accounting Series No. 236: The FASB Report,* September 30, 2002, p. 1. Bielstein, interview, March 19, 2007.

short-term international convergence project to its agenda.[107]

A milestone was reached when, on October 29, 2002, the two Boards issued the Norwalk Agreement. In it, they pledged their best efforts to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate their work programs to ensure that compatibility was maintained through (a) aiming the short-term project at removing a variety of individual differences between GAAP and International Financial Reporting Standards (IFRSs), (b) removing other differences between GAAP and IFRSs by addressing concurrently new, discrete, substantial projects (mutual undertakings), (c) continuing progress on the joint projects they were then undertaking, and (d) encouraging their respective interpretive bodies to coordinate their activities. In addition, both Boards noted that the intended implementation of the IASB's IFRSs in several jurisdictions (the EU member countries) on or before January 1, 2005, would require that they pay attention to the timing of the effective dates of new or amended reporting requirements.

Before and after the Norwalk Agreement, the Boards developed various ways of working together to achieve their shared convergence goals. The FASB's principal cooperative efforts included (1) joint projects conducted with the IASB, (2) the short-term Convergence Project, (3) liaison IASB member on site at the FASB offices, (4) FASB monitoring of IASB projects, and (5) explicit consideration of convergence potential in all Board agenda decisions. Each is discussed briefly below.

1. <u>Joint projects conducted with the IASB</u>**.** Joint projects were those that the two standard setters had agreed to conduct simultaneously in a coordinated manner, with the objective of issuing common standards. In 2008, the FASB and IASB were conducting joint projects to address a common Conceptual Framework, Revenue Recognition, Business Combinations,[108] and Financial Statement Presentation.

2. <u>The short-term convergence project</u>. The scope of the short-term convergence project was limited

[107] The next day, the *Wall Street Journal* reported: "The board that sets US accounting standards formally approved a project to study potential areas of convergence between US and international accounting rules." "FASB Backs Project To Study Unification Of Accounting Rules," October 3, 2002, p. C9.

[108] Business Combinations, Part II, was completed with the issuance of FAS 141R (revised in 2007) and a revised IFRS 3 (issued in January 2008).

to those differences between GAAP and IFRSs in which convergence around a high-quality solution was achievable in the short-term, usually by choosing between the existing IFRS and GAAP guidance. By 2008, progress had been made by both Boards, including: (1) the FASB issued new or amended standards that (a) introduced a fair value option (SFAS 159) and (b) adopted the IFRS approach to accounting for research and development assets acquired in a business combination (SFAS 141R); and (2) the IASB published new standards on borrowing costs (IAS 23 revised) and segment reporting (IFRS 8). With the 2006 Memorandum of Understanding the two Boards shifted their emphasis from short-term to long-term projects. That emphasis remained with the 2008 update to the 2006 MoU.[109]

3. Liaison IASB member on site at the FASB offices. James J. Leisenring, a former FASB Board member, was the IASB member to fill the role of liaison Board member to the FASB.[110] The role was created by the IASB to facilitate information exchange and increase cooperation between the FASB and the IASB. FASB Chairman Herz interfaced regularly with Leisenring, who also attended board and senior staff meetings. Herz observed that Leisenring effectively represented the IASB's views and tried not to let his own views color his representations of them.[111]

4. FASB monitoring of IASB projects. The FASB Board and staff monitor IASB projects, both to gain insights into IASB thinking on issues and to provide the IASB with FASB insights. Monitoring was principally achieved through monthly IASB update meetings led by IASB liaison member Leisenring and held the week after the IASB meeting. They provided the FASB Board and staff the opportunity to learn about IASB decisions and to provide any

[109] Sue Bielstein, interview, January 23, 2009.

[110] Leisenring was the only IASB liaison Board member to the FASB. This formal liaison role was eliminated when his term as an IASB member ended, presumably because the Boards' close working relationship and frequent joint meeting schedule eliminated the need for it. Sue Bielstein, email to author, November 16, 2011.

[111] Robert Herz, interview, March 19, 2007.

insights from a US standard-setting perspective.[112]

5. Explicit consideration of convergence potential in all board agenda decisions. All topics formally considered for inclusion on the FASB's agenda needed to be assessed for the possibilities for cooperation with the IASB.

At their joint meeting in April 2004, the two Boards agreed that, in principle, joint projects were the most practical means of achieving the goal of common standards. Consequently, they reached the decision that new standards in major areas should be developed through joint projects. Both considered how they should approach major projects underway by one but not the other (for example, the FASB had a project underway on liabilities and equity that the IASB was not directly involved in, and the IASB had an active project on accounting for insurance contracts). FASB Board member Ed Trott proposed a modified joint approach to those projects under which one Board would take the lead in developing a discussion paper. After considering constituent input on the paper, the project would become joint and the Boards would work together to develop common Exposure Drafts and final standards.[113]

Another milestone in the Boards' working relationship occurred in late 2004. At the FASB/IASB joint meeting in Norwalk on October 19-20, both decided to add to their agendas a joint project on a conceptual framework to be based upon and build from the existing FASB *Concept Statements* and the IASB *Framework for the Preparation and Presentation of Financial Statements*. The two Boards concluded that differences between their existing frameworks might impede development of common standards in current and future projects.[114] On July 6, 2006, they published the first draft chapters of their joint conceptual framework.

In 2005, SEC Chief Accountant Don Nicolaisen put forward a "Roadmap" for the removal of the reconciliation requirement by 2009 for non-US companies that use IFRSs and register in the US.[115] That Roadmap identified several milestones to be

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[112] Sue Bielstein, interview, March 19, 2007.

[113] Sue Bielstein, interview, March 19, 2007, and "FASB and IASB Discuss Plans for the Future," *Financial Accounting Series No. 256: The FASB Report,* May 28, 2004, pp. 1 and 6.

[114] *The FASB Report*. November 30, 2004.

[115] For a look at the Roadmap, see Nicolaisen's "A Securities Regulator Looks at Convergence," www.sec/gov/news/spch040605dtn.htm, and *Northwestern Jour-*

achieved before the SEC staff would recommend removal of the reconciliation requirement. One of those milestones was progress by the IASB and FASB on their convergence work programs.

Also in 2005, the SEC adopted an accommodation to permit foreign private issuers that were first-time adopters of IFRS, for the first year of reporting under IFRS, to file two years instead of three years of IFRS financial statements in their SEC filings.[116] (IAS 1, ¶ 38 requires two years of comparative data.)

Following the issuance of the Roadmap, the FASB and IASB decided to develop and issue a document on the scope of their joint work program and the progress expected to be achieved by 2008. Representatives of both organizations consulted representatives of the European Commission and the staff of the SEC, with the Boards' respective advisory councils and other interested parties.[117] On February 27, 2006, the FASB and IASB issued a Memorandum of Understanding (MoU), "A Roadmap for Convergence between IFRSs and GAAP—2006-08" to communicate their convergence work program.[118]

In developing the MoU, the two Boards agreed on the following principles:

- Convergence of accounting standards can best be achieved through the development of high-quality, common standards over time.

- A new common standard should be developed that improves the financial information reported rather than trying to eliminate differences between two standards in need of significant improvement.

- Serving the needs of investors means replacing weaker standards with stronger standards.

On February 27, 2006, the SEC welcomed the FASB/IASB MoU. SEC Chairman Christopher Cox, who had for weeks publicly stressed the SEC's commitment to the "roadmap" said, "The SEC is working diligently toward the goal of eliminating the existing IFRS to GAAP reconciliation requirement. Achieving that

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nal of International Law & Business. Spring 2005. V. 25 (no. 1), pp. 661-686.

[116] "First-time Application of International Financial Reporting Standards," Securities Act Release No. 33-8567, April 12, 2005.

[117] "FASB and IASB Publish Memorandum of Understanding," *Financial Accounting Series No. 278-B: The FASB Report,* March 31, 2006, pp. 1and 3.

[118] Sue Bielstein, interview, March 19, 2007.

goal depends on the contributions of many parties, including US and international standard setters. This important step by IASB and FASB will help ensure that investor protection remains paramount in these efforts."[119]

A key issue at the April 2008 joint meeting of the two Boards was updating the 2006 MoU.[120] On September 11, the Boards issued a joint progress report[121] which noted that, at their joint April meeting, they confirmed their commitment to developing common, high-quality standards and agreed on a pathway to completing the MoU projects by 2011.

On June 20, 2007, in a move that the IASB had been hoping for and expecting,[122] the SEC approved for public comment a proposed rule to accept foreign private issuers' financial statements prepared according to the English language version of IFRS as published by the IASB without requiring reconciliation to GAAP.[123]

On November 2, 2007, in a two-part letter addressed to Ms. Nancy M. Morris, Securities and Exchange Commission, FAF Chairman Robert E. Denham and FASB Chairman Robert H. Herz wrote, "Board members and trustees strongly support the proposal…that US public companies *transition to an improved version* of international accounting standards" (italics added). The main points were: (1) investors would be better served if all US companies used accounting standards issued by a single global financial reporting standard setter; permitting extended periods of choice between GAAP and IFRS would result in a two-GAAP system that would create unnecessary complexity for users of financial statements; (2) the FAF, FASB, SEC, and other affected parties should work together to develop a "blueprint" for transitioning US companies to IFRS— an "'improve-and-adopt' process"; and (3) the SEC should seek international cooperation to identify and implement changes necessary to sustain the IASB and to secure it as the independent global body that promulgates high-quality international accounting standards.

[119] www.sec.gov/news/press/2006-27.

[120] David Tweedie, email to author, August 14, 2008.

[121] Press Release, IASB and FASB publish update to 2006 Memorandum of Understanding. With the 2006 MoU the two Boards shifted their emphasis from short-term projects to long-term projects. That emphasis remained with the 2008 update to the 2006 MoU. Sue Bielstein, January 23, 2009.

[122] Anthony Cope, email to author, August 26, 2008.

[123] "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to GAAP," Securities Act Release No. 33-8818, July 2, 2007.

Stable and sustainable funding was required, including staffing mechanisms for the IASB, as well as agreements to end the jurisdictional review and endorsement processes that require endorsement of each IFRS after the IASB issues it.[124]

On December 21, 2007, the SEC released a final rule permitting such foreign private issuers to file their financial statements without reconciliation so long as they complied with IFRS issued by the IASB.[125] The SEC allowed IFRS-compliant interim financial statements, and extended indefinitely the two-year accommodation.[126]

Even before the SEC issued the final without-reconciliation rule for foreign private issuers employing IFRS, in light of the ongoing FASB/IASB convergence activities and the movement outside the US toward acceptance of IFRS financial statements, the Commission issued a concept release[127] on allowing US issuers to prepare IFRS-compliant financial statements as a basis of financial reporting.[128]

On August 27, 2008, the SEC issued a press report that the Commission had voted to issue a proposed roadmap that could lead to the use of IFRS instead of GAAP by US issuers beginning in 2014. The proposed multi-year plan would establish a number of milestones that, if achieved, could lead to the use of IFRS by US issuers in their SEC filings. After reviewing the status of the proposed milestones, the Commission would decide in 2011 whether adoption of IFRS was in the public interest and would benefit investors. Chairman Cox said, "The increasing worldwide acceptance of financial reporting using IFRS, and US investors' increasing ownership of securities issued by foreign companies that report financial information using IFRS, have led the Commission to propose this cautious and careful plan.[129]

Although the New York Stock Exchange had reached a high

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[124] Financial Accounting Foundation, December 18, 2007, pp. 2, 3, 7 and 11.

[125] Also, without EU carve-outs. Hans Burggraaff, email to author, September 8, 2008.

[126] "Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards without Reconciliation to GAAP," Securities Act Release No. 33-8879, December 21, 2007.

[127] This concept release came as a surprise to the IASB. Anthony Cope, email to the author, August 26, 2008.

[128] "Concept Release on Allowing US Issuers to Prepare Financial Statements Prepared in Accordance with International Financial Reporting Standards," Release No. 33-8831, August 7, 2007.

[129] "Press Release: SEC Proposes Roadmap Toward Global Accounting Standards to Help Investors Compare Financial Information More Easily," sec.gov/news/press/2008/2008-184.htm.

of over 14,000 in October 2007, by September 2008 a worldwide credit and liquidity crisis had engulfed capital markets and raised questions about the application of fair value reporting in inactive markets. In the midst of these developments, the fair value controversy heated up to such an extent that the SEC Office of the Chief Accountant and the staff of the FASB felt compelled to issue a clarifying press release on September 30, 2008.[130] Based on the fair value measurement guidance in FAS No. 157, Fair Value Measurements, the SEC and FASB staffs intended their joint clarifications to help preparers, auditors, and investors address the urgent fair value measurement questions in the depressed economic environment.[131] Within days, the IASB staff concluded that the SEC-FASB clarification was "not an amendment to FAS 157…but rather provides additional guidance for determining fair value in inactive markets…and considers it consistent with IAS 39, *Financial Instruments: Recognition and Measurement.*"[132] In order to converge its standards with the FASB's, the IASB short-cut its own due process. It issued an amendment to permit reclassifications of financial assets under certain circumstances (October 13); proposed enhanced disclosures of financial instruments (October 15); and published guidance for the application of fair value in illiquid markets (October 31).[133]

The worldwide recession of 2008 did not dissuade the SEC from moving ahead with the issuance of its <u>Roadmap for the potential use of IFRS financial statements by US issuers.</u> On November 14, 2008, the SEC posted the proposed Roadmap on its website (sec.gov). It set forth seven milestones, including the implementation of the mandatory staged use of IFRS by US issuers.[134]

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[130] Shortly thereafter, the FASB issued an FSP that included the guidance in the press release, making it authoritative. Sue Bielstein, March 2009.

[131] Press Release: SEC Office of the Chief Accountant and FASB Staff Clarification on Fair Value Accounting, <u>www.fasb.org/news/2008-FairValue.pdf</u> .

[132] See: International Accounting Standards Board Press Releases: "IASB Staff position on SEC-FASB clarification on fair value accounting," October 2, 2008, and "IASB announces next steps in response to credit crisis," October 3, 2008, at www.iasb.org.

[133] The IASB was criticized heavily for short-circuiting its due process. *World Accounting Report* commented, "In an astonishing *volte-face*, the IASB has had to bow to political pressure and abandon both a key tenet of IAS 39 and its own due process….[The IASB's] independence and credibility have been called into question, and the banking lobby has once again demonstrated its political clout." (pp. 2-3)

[134] <u>Proposed Rule: Roadmap for the Potential Use of Financial Statements Prepared</u>

The SEC proposed to amend its rules to permit a limited number of US companies (estimated to be 110 in 37 IFRS industries) to voluntarily use IFRS for their annual reports, beginning with filings in 2010. In the event the SEC ultimately decided not to issue a rule requiring all US listed companies to use IFRS, these companies would be required to return to the use of GAAP. Nevertheless, by the end of 2008 a sea change had occurred in US financial reporting regulation, with the SEC permitting foreign private issuers to report according to IFRS without reconciliation to GAAP, and with the possibility that the SEC would soon require US listed companies to gradually shift to the use of IFRS.

In addition, the working relationship between the FASB and the IASB in 2008 was different than it was in the early days (2001), when each board had its own projects and there were few joint projects. By 2008, staff members were crisscrossing the Atlantic as they worked together on several joint projects. The Boards' respective agendas were quite similar and both had regularly scheduled joint meetings.[135]

The year 2008 ended with the world deep in recession. On December 30, the FASB and the IASB announced the membership of the Financial Crisis Advisory Group (FCAG), which they had established to consider financial reporting issues arising from the global financial crisis. The two Boards would jointly consider any FCAG recommendations; any decisions by them would "be subject to appropriate and thorough due process." Thus, the global economic recession had driven the Boards to even closer cooperation as they struggled individually and together to respond quickly to the accounting issues that had arisen from the crisis. In the USA, a new president, Barack H. Obama, was elected. In January 2009, he would replace George W. Bush. A new wind would blow across the US capital. In December 2008, the implications for convergence remained to be seen.

SUMMARY AND PROSPECT

The US Financial Accounting Standards Board and the International Accounting Standards Committee were formally established in 1973. In the early years, these two NGOs tended

in Accordance with International Financial Reporting Standards by US Issuers (Release No. 33-8982; Nov. 14, 2008), pp. 9-37.

[135] James Leisenring, IASB Member and Liaison to US FASB, interview, June 15, 2007.

to operate more or less in their own spheres. Over time, the relationship between them evolved from distant to IASC Board observer, from occasional partner to full partner holding regular joint meetings with the IASB.[136] By 2008, virtually all of the FASB's major projects were being developed in partnership with the IASB, whose standards had achieved wide acceptance. By 2008, 113 countries had either required IFRS, intended to require IFRS, or permitted their use.[137]

As the two groups grew closer together, the role of FASB's overseer, the SEC, became more and more pronounced. Since adoption of IAS/IFRS by the US has been a major objective of the IASC(B), the SEC, which has the legal responsibility for accounting standards in the US, was bound to take a significant role in the developments.[138] It was a major player in the IASC's restructuring efforts in 1998-2000; and it had a pronounced impact on the subsequent convergence efforts of the IASB and FASB. It even drafted the "roadmap" for acceptance of IFRS statements without reconciliation to GAAP, which, following its publication, further influenced the convergence efforts of both Boards.

In the beginning, the FASB was charged with the formulation of high-quality financial accounting and reporting standards for the US capital markets; the SEC recognized the FASB's standards as "authoritative" and "generally accepted" for purposes of US federal securities laws. The IASC saw its mission as the establishment of high-quality international accounting standards that could be used for world capital markets. Its efforts were not overseen[139] nor subject to approval of a single regulator.[140] In the early years, the FASB's standards were often regarded by others as well as by itself as the finest in the world. On the other hand, the IASC often felt it necessary to defend itself against the charge that, since it allowed a number of alternative accounting treatments, its standards were the lowest

[136] David Cairns, email to author, September 11, 2011. "[A] downside to this is that some other countries think the US has too much influence on IFRS."

[137] David Tweedie, email to author, August 14, 2008.

[138] David Cairns, email to the author, September 11, 2011.

[139] This changed in 2010 with the establishment of an independent Monitoring Group.

[140] David Cairns, email to author, September 11, 2011. "But the role of the monitoring board is different from that of the SEC in the US. The parallel to the SEC's role in the US would be, for example, an international regulator with not only authority over the IASB but also authority over financial reporting requirements in all jurisdictions."

common denominator.

The standards orientations of these two important NGOs have often been perceived as decidedly different. The US FASB has been accused of promulgating high-quality, extremely detailed, complicated rules-based standards. The IASC/IASB has prided itself on its inclination to issue principle-based standards that, over time, have been enhanced as a result of various improvement projects to become high-quality standards. With the accounting scandals in the US in the late 1990s and early 2000s, the US Congress charged the SEC to study the appropriateness of principles-based standards for the US. Moreover, the FASB conducted a study of the appropriateness of such standards. Under the Chairmanship of Robert H. Herz, the FASB embarked on a three-pronged approach to standard setting: improvement, simplification, and convergence. Improvement involved bettering the accounting literature, leading to the FASB's Codification Project. Simplification involved not only having the FASB as the single standard setter, but also codification of the existing US accounting standards and relevant SEC guidance, and trying to improve the understandability of new accounting standards issued by the FASB. Convergence was launched with the Norwalk Agreement of 2002.[141]

Over time, the goals of these two NGOs converged. The FASB expanded its mission to encompass high-quality financial accounting standards for the US and working toward the goal of common standards for the world's capital markets. In addition, both the FASB and the IASC (later IASB) saw the need to converge their respective standards in order that a worldwide set of Generally Accepted Accounting Principles could evolve. By 2008, each organization was involved intimately with the other in a multiyear effort to that end. While the goal of their convergence efforts was common standards, they sometimes fell short of that objective. At times, those differences resulted from factors unique to one jurisdiction or another that would take time to resolve. For example, when the IASB revised its inventory standard, it eliminated the last-in first-out (LIFO) method of inventory valuation. In 2008, LIFO was still an accepted US inventory valuation method that seemed unlikely to go away any time soon due to the LIFO conformity rule of the US Internal Revenue Service, which required use of LIFO for financial

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[141] Ellen M. Heffes, "For FASB's Herz: 'The Ultimate Destination—A Single Set of Common Standards,'" Financial Executive. v. 23, no. 6, July/August 2007, pp. 12-14.

reporting purposes when used for tax reporting.[142] Thus, while convergence was indeed occurring, differences persisted.

The efforts of the IASB since 2001 had been sufficiently successful that they had convinced both their supporters and their critics, including the SEC, that International Accounting Standards/International Financial Reporting Standards (IAS/IFRS) had become a set of high-quality accounting standards suitable for use by global companies to list on US exchanges without reconciliation to GAAP. The SEC even went so far as to issue a Concept Release in 2007 to investigate whether US-based issuers should be permitted to file and report using IAS/IFRS instead of GAAP financial statements for listing on US capital markets, and to propose, in 2008, a roadmap for achieving their adoption by US firms. Still, in 2008, there existed the simultaneous use of both sets of standards in the US. However, SEC actions in 2007 and 2008 had affirmed the prescient observation of former IASC Chairman Arthur Wyatt that "the ultimate resolution of the standard-setting dilemma internationally…will lie in the hands of the regulators…"(see above.) This certainly had proven to be the case in the US.

Once the FASB and the IASB gradually bring their convergence efforts to completion over the next number of years, what lies ahead? Will the simultaneous use of the two sets of standards, GAAP and IFRS, continue into the long future? (This seems less likely for listed companies, with the August 2008 SEC proposal to permit US issuers to use IFRS.) Will the IASB continue to promulgate high-quality standards now that the original members have retired from the Board? If the world's capital markets perceive a decline in the quality of IFRSs in the future, will the FASB become the *de facto* international standard setter, assuming that GAAP retains its reputation for high quality and that international opposition to American GAAP ceases?

Will the FASB continue to exist if US-based listed companies switch, either voluntarily or involuntarily, to wholesale use of IFRSs?[143] Will there continue to be a need for a US national accounting standard setter, perhaps smaller in size, to serve the needs of non-public companies that might choose to continue to use GAAP? Will the FASB continue to provide advice to the

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[142] David Tweedie, email to author, August 14, 2008. "If the US adopts the IFRS then LIFO will be an issue but this issue is already being considered by the [Internal] Revenue Service."

[143] Sue Bielstein observed that, to date, no national standard setter has been eliminated in those countries which have adopted IASs/IFRSs. Interview, January 23, 2009.

IASB?

What will be the role of the SEC in a world of harmonized financial accounting standards for filing, reporting, and listing on US exchanges? What role will the US Congress perceive to be the proper one for the SEC in a world of converged financial reporting standards?

Whatever answers to these questions emerge, it is clear that interesting times are likely to lie ahead for FASB and IASB standard setters as they wrestle with present and future financial accounting standard setting and reporting challenges.

EPILOG

Since December 31, 2008, there have been a number of personnel changes. For example, the Obama Administration named Mary Shapiro Chairman of the SEC. During the fourth year of his second five-year term, Robert Herz, FASB Chairman, resigned, effective September 30, 2010; he was succeeded by Leslie Seidman. Sir David Tweedie, IASB Chairman, completed his second five-year term on June 30, 2011; he was succeeded by Hans Hoogervorst.

The FASB/IASB International Convergence Project has continued, although progress has not been as rapid as originally hoped. Following their joint meeting in London on April 11-14, 2011, the two Boards reported on the progress of their joint convergence work. Since their earlier November 2010 report, the IASB and the FASB have:

1. *Completed five projects:* The Boards have reached important decisions on a number of projects and reduced the number of remaining priority MoU projects to three (revenue recognition, leasing, and financial instruments). Publication of standards that are converged or substantially converged on fair value measurement, consolidated financial statements (including disclosure of interests in other entities), joint arrangements, other comprehensive income, and post-employment benefits were expected in 2011.
2. *Given priority to the remaining MoU areas and insurance accounting:* In November 2010, the Boards decided, in order to achieve timely completion, to give priority to their joint work on three MoU projects—financial instruments, revenue recognition and leases—and on accounting for insurance contracts.
3. *Extended the completion target beyond June 2011:* At their meeting in April 2011, the Boards extended the timetable for the

remaining priority MoU convergence projects and for insurance beyond June 2011. The Boards revised their work plan to focus on completing the three remaining priority convergence projects in the second half of 2011. For insurance contracts, the IASB planned to complete its project by the end of 2011, while the FASB planned to issue an exposure draft in a similar timeframe.

With the progress made since November 2010, the Boards neared the completion of their MoU program, which began in 2002. The short-term projects identified for action in their 2006 MoU and updated 2008 MoU have been completed or come close to completion.

Of the longer-term projects, only three of the priority convergence projects remain for which the Boards have yet to finalize the technical decisions: financial instruments, revenue recognition, and leasing.

In 2008, the Boards set the target date of June 30, 2011, to finalize the MoU projects. At their meeting in April 2011, they agreed that they would spend additional time beyond June to complete this joint work. They were committed to completing the work in the remaining MoU areas during the second half of 2011. This objective was consistent with the recommendations of G20 made at their 2009 Pittsburgh Summit.[144]

In the belief that it was necessary to specify the work required to incorporate IFRS into the US financial reporting system for US issuers, including the scope, timeframe, and methodology for any such transition, in February 2010 the SEC directed the staff of the Office of the Chief Accountant to develop and carry out a Work Plan. This Work Plan was to set forth specific areas and factors to consider before potentially transitioning the current financial reporting system for US issuers to a system incorporating IFRS. Assuming that the Commission determined in 2011 to incorporate IFRS into the US domestic reporting system, the SEC concluded that the first time US issuers would report under such a system would be approximately 2015 or 2016.[145]

[144] Progress report on IASB-FASB convergence work, 21 April 2011, www.fasb.org.

[145] Commission Statement in Support of Convergence and Global Accounting Standards, Securities and Exchange Commission, Release No. 33-9109, February 24, 2011, pp. 13-14.

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THE OLD DU PONT COMPANY'S ACCOUNTING SYSTEM LASTING A HUNDRED YEARS: AN OVERLOOKED ACCOUNTING SYSTEM

Abstract: Accounting historians have not yet realized that there existed another complete accounting system before the formation of the modern accounting system of today which Johnson and Kaplan's *Relevance Lost* characterizes by the "integration" of cost and financial accounts supported by "inventory costing." In that earlier accounting system, cost and profit calculations were made in a past particular ledger account or accounts, namely trading account(s), where accounting practices opposed to "inventory costing" and "integration" were used. The historical existence of that accounting system is overlooked by accounting historians. The example of the old Du Pont Company (DPC) this paper presents will bring it to light.

Cost and profit calculation were made in four trading accounts in the double-entry ledger at the old DPC as it was purchased by the new DPC in 1902. One of its trading accounts dated back to 1804 when the old DPC started production of gunpowder. Early cost and profit calculations in that trading account were examined by the new DPC's staff in the early 1940s. They prepared schedules showing the cost data, sales revenues, and profit measurement recorded in the early trading account. These schedules give evidence that the old DPC recorded the costs incurred and used the cost data to compute profit for financial accounting purposes, but in different ways from today's "inventory costing" and "integration." This old DPC's accounting system resulted from the application of the double-entry system to industrial accounting and was in use throughout the nineteenth century. By revealing the historical existence of that overlooked accounting system, this paper will show that accounting history may be described as evolution of the traditional accounting system made through double-entry bookkeeping in which the trading account was of vital importance and the transition from that traditional accounting system to the modern integrated accounting system supported by inventory costing.

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INTRODUCTION

Johnson and Kaplan [1987] describe accounting history as evolution of management accounting and the formation of "inventory costing" supporting the "integration" of cost and financial accounts as a turning point of that evolution. This paper will show that accounting history may be described as evolution of cost and profit calculation for financial accounting purposes and that the formation of "inventory costing" supporting "integration" may be regarded as a turning point of this evolution.

Johnson and Kaplan [1987] give the definition of the integration of cost and financial accounts as follows: "The term *integration* meant that all amounts reported in financial statements, whether they were period expenses or end-of-period assets, had to be traceable to original (*i.e.*, historical) cost of recorded transactions [p.131; emphasis in original]. This "integration" was supported by "inventory costing – a bookkeeping procedure that manufacturing accountants follow to separate the production expenses of an accounting period from the cost of manufactured product inventories at the end of the period" [p.130]. Inventory costing that Johnson and Kaplan refer to is today's costing for financial accounting purposes. According to Johnson and Kaplan [1987, p.130], "inventory costing " was promoted by public accountants after 1900. Before that, "inventory costing" was not executed and "manufactured inventories" were valued "with dollar amounts that originated outside the books of account" [p.131]. Johnson and Kaplan strongly contend that before 1900 "inventory costing" supporting "integration" was lacking in the chapter sub-titled "Relevance Lost" in their book. Three points may be made regarding that Johnson and Kaplan's observation.

It should be noted, at first, that Johnson and Kaplan characterize the modern accounting system of today by the integration of cost and financial accounts supported by inventory costing.

Second, Johnson [1972, p.469] find "a completely integrated double-entry cost accounting system" at Lyman Mills in the mid-nineteenth century. That is based on the fact that the two mill accounts in Lyman Mills' home office (general) ledger constituted "trading accounts" which contained "entries for non-manufacturing expenses and sales in addition to entries for manufacturing expenses" to "provide profit and loss data useful in determining the semi-annual dividend to shareholders" [p.471].[1] Johnson's contention that Lyman Mills had a integrated

[1] Lyman Mills had "a double-entry general ledger..., as well as a double-entry

accounting system is definitely denied by Johnson and Kaplan [1987]. They note that "Lyman Mills did not compile cost accounting data in their mill accounts in order to attach cost to product inventory for financial reporting purposes" [p.28]. Thus Johnson and Kaplan present the Lyman Mills case as one that gives evidence that "inventory costing" supporting "integration" did not existed before 1900. However, it should be noted that they still acknowledge that cost data were used to compute profit in the trading accounts for financial accounting purposes noting that Lyman Mills' trading accounts "provided profit and loss data useful in determining the semiannual dividend to shareholders" [Johnson and Kaplan, 1987, p.28]. In short, Johnson and Kaplan deny the presence of "inventory costing" and "integration" at Lyman Mills in the mid-nineteenth century, on the one hand, and acknowledge the presence of costing for financial accounting purposes different from inventory costing, on the other.

Third, although they acknowledge the presence of costing for financial accounting purposes before 1900, Johnson and Kaplan [1987] minimize this fact and finally renounce acknowledging this fact in the chapter sub-titled "Relevance Lost" in their book.[2] They treat costing practices before 1900 only from the angle of management accounting. Thus they describe accounting history as evolution of management accounting.

Of the three points above, only the third point influenced accounting history research. Historical studies from the angle of management accounting, represented by Fleischman and Parker [1997], flourished after the publication of Johnson and Kaplan [1987].[3] The second point above was completely neglected by the historical studies on management accounting and by accounting history studies in general. The objective of this paper is to shed light on that neglected issue of accounting history research. This

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factory ledger"[Johnson,1972, p.469]. Fujimura [2003] specified the relationship between the two kinds of ledgers which Johnson [1972] failed to do.

[2] The following passage is found in the chapter the Lyman Mills' case is treated. "...they provide cost information that is systematically and reliably reconciled with profit and loss. But Lyman Mills managers did not invest resources in the compilation of this information in order to prepare their semiannual financial reports" [Johnson and Kaplan, 1987, p.30]. The last sentence gives the impression that Johnson and Kaplan deny any use of costing for financial accounting purposes. However, it only means that inventory costing was not executed. As the preceding observation suggests, they acknowledge that cost data were used to compute profit.

[3] See Fleischman [2009] which is the most recent review article on studies of management accounting history.

paper treats the system of cost and profit calculation for financial accounting purposes found at the old Du Pont Company (DPC) that lasted a hundred years from the American Industrial Revolution. As seen later, the old DPC used a trading account or accounts that recorded costs to compute profit for financial accounting purposes.[4] Costing for financial accounting purposes performed in the trading account, namely that past practice opposed to "inventory costing" for today's integrated accounting system, is the issue this paper addresses.

This issue, which relates to the second point above, has been completely neglected by accounting historians. To be sure, some authors such as J. R. Edwards and T. Boyns paid attention to the financial accounting aspect of earlier accounting practices. However, they did not address the trading account, nor did they treat costing for financial accounting purposes. For example, Boyns, Edwards, and Nikitin [1997], which includes the summaries of earlier works of themselves and others, noted: "for the period and firms studied, there was a single, integrated accounting system"[p.16]. They used the word "integrated" to indicate that they found a financial accounting aspect in earlier accounting practices. However, the use of the word "integrated," at the same time, means that they were indifferent to the difference between costing practices of the past and inventory costing for today's integrated accounting system. It further means that they were indifferent to costing for financial accounting purposes itself. In fact, their interest was only in "the practice of cost calculation...for managerial purposes [Boyns, Edwards, and Nikitin, 1997, p.16]. They did not address the issue of costing for financial accounting purposes, nor did they approach the process of profit calculation for financial accounting purposes, which was recorded in the trading account. They showed no interest in the trading account which is the key account to recognize the past particular accounting system for what it was. In fact, in the case studies made by Edwards and Boyns [1992] and Edwards, Boyns, and Anderson [1995], they did not notice the presence of trading accounts although some accounts in the cases may be regarded as trading accounts. This is because their research focused only on costing for management accounting purposes. The trading account and the issue of costing for financial accounting purposes were outside their interest. From their approach, evolution of accounting attaining to today's integrated

[4] The precise definition of the trading account will be given when treating the old DPC's early trading account.

accounting system can not be described; besides, the question as to when and how today's integrated accounting system was formed can not be posed. In this sense, their studies are not historical studies.

The preceding discussion indicates that there is a serious, unbelievable gap in accounting history research. The system of cost and profit calculation for financial accounting purposes that existed before the advent of today's integrated accounting system remains unknown. Accounting historians have never imagine that there existed another system of cost and profit calculation for financial accounting purposes in earlier times. The historical existence of another accounting system was suggested by Johnson and Kaplan [1987] as the second point noted earlier and by Fujimura [2000; 2007], but they have not drawn the least attention of accounting historians. The gap remains. The objective of this paper is to fill this gap in accounting history and by that, to present a new understanding of accounting history, based on the example of the old DPC.

There are complete series of double-entry ledgers and journals of the old DPC from its founding year, 1801, through its end, February 1902, among the old company's numerous accounting records comprising the collection Accession 500, Series I housed in the Hagley Museum and Library (formerly the Eleutherian Mills Historical Library). These books of account have been available since before Chandler and Salsbury [1971], for the purpose of describing the early history of the new DPC, searched the documents housed, at that time, in the Eleutherian Mills Historical Library. However, except Roxanne T. Johnson [1989], academics have paid little attention to the old DPC's books of account. R. T. Johnson examined the ledgers, the journals, and other books of account of the early nineteenth century DPC, but could not notice the presence of a trading account. As a result, she could not comprehend the accounting system of the old DPC at all. Her failure reflects the existing state of accounting history research that still continues. The trading account was not in her mind as were and are the other accounting historians.

In order to find out the presence of trading accounts, the writer surveyed all the ledgers of the old DPC and made closer examinations of the first two volumes covering the years 1801-1816 and the last two volumes covering the years 1891-1902.[5] In its early years, DPC opened only one trading account in its

[5] See References at the end of this paper.

ledgers, which was named "Factory." In its last two ledgers, there were four trading accounts: in addition to the long lasting "Factory" account summarizing the operating activities of the black powder mills in Wilmington, the "Wapwallopen Mills" account for the black powder mills on Wapwallopen Creek, Pennsylvania, the "Iowa Powder Mills" account for the black powder mills in Mooar, Iowa, and the "Gun Cotton Works" account for the smokeless powder works at Carney's Point, New Jersey.[6] The profits or losses determined in the four trading accounts were transferred to the "Profit and Loss" account to which the dividends paid were debited.

The writer was not the first to examine the old DPC's trading accounts. It was done by the new DPC's staff a long time ago. Documents showing that the new DPC's staff examined the old DPC's books of account are found in a huge collection, The Longwood Manuscripts, Group 10, Papers of Pierre S. du Pont (1870-1954), housed in the Hagley Museum and Library. This collection was what Chandler and Salsbury [1971] used as their "basic source of information" [p.615]. As well as the documents used by Chandler and Salsbury, the collection includes the documents pertaining to the historical studies of the old company's accounting records made by anonymous staff of the new DPC, to whom the traditional accounting system must have been of the near past. The studies cover the whole period of the old company's existence, and almost all documents are undated. Among these documents are found two sets of schedules covering the old company's early years, one covering the years 1802-1809, and the other the years 1810 -1815. Each set includes a balance sheet, a profit and loss statement, a schedule showing a process of profit determination in the "Factory" account, a schedule summarizing the cost debited to the "Factory" account, and a schedule summarizing the sales credited to the "Factory" account, as well as a schedule calculating a return on investment. This paper uses the schedules covering the years 1802-1809. As will be seen later, the schedules suggest that the old DPC's trading account, namely the "Factory" account, by recording costs on its debit and sales on its credit, played a central role in profit measurement as did the mill trading accounts in Lyman Mills' home office ledger. An accounting system such as that found at the mid-nineteenth century Lyman Mills, which was

[6] The "Wapwallopen Mills" account was opened in May 1859, the "Iowa Powder Mills" account in September 1888 and the "Gun Cotton Works" account in December 1892 [Ledgers C, No.9, and No.10].

characterized by the use of the trading account, was found at the early nineteenth century DPC. The records in the "Factory" account will show that there was another costing for financial accounting purposes different from inventory costing for today's integrated accounting system.

As evidenced by the ledgers noted earlier, trading accounts were used at the old DPC until it was purchased by Coleman, Alfred, and Pierre S. du Pont. After purchasing the old company, Pierre S. du Pont examined the old company's books of account [Chandler and Salsbury, 1971, pp.54-55]. No one has ever indicated that Pierre questioned the old company's trading accounts. The use of the trading account was a common practice at that time. That old company's accounting system dated back to the early nineteenth century, when Chandler [1977] described "the traditional enterprise" prevailed. This paper addresses such a long lasting accounting system. This long lasting accounting system existed before the advent of today's integrated accounting system. It is such an accounting system that has been overlooked by accounting historians. Therefore, the revelation of the historical existence of another accounting system will lead to the overall revision of the existing understanding of accounting history. This paper will present a new understanding of accounting history, about which some discussion will be made at the end of this paper.

OWNERS' EQUITY AND DISTRIBUTION OF PROFITS

E. I. du Pont de Nemours and Company, the old DPC, was, at first, organized in Paris on April 21, 1801 for the term expiring January 1, 1810, in order to establish a powder works in the United States. Eleuthère Irénée du Pont, as "the Superintendent of the Manufactory (*le Directeur de la Manufacture*)," was responsible for constructing and running the powder works ["*Acte d'association* (deed of association)," LMSS].[7] In accomplishing these tasks, he transferred the French gunpowder technology to the United States [Stapleton, 2006]. The powder works was constructed on a land of 65 acres on the Brandywine River, four miles upstream from Wilmington, Delaware, which was pur-

[7] An English translation is in R. T. Johnson [1989, Appendix A]. Another English translation entitled "Original Articles of Partnership" is in LMSS. The two English versions are a little different from each other and do not translate all the articles of the French original version. Hereafter only the French version will be referred to.

chased in 1802 and production started in 1804 [Kinnane, 2002].[8] The deed of association (*Acte d'association*) stipulated that books be closed and profit be distributed every year. However, except an incomplete one, the closing process occurred only at the end of the term of association on December 31, 1809.

Table 1 is the balance sheet prepared by the new DPC's staff. The old DPC itself did not prepare separate financial statements at that time. Instead, the old company on December 31, 1809 closed the balance sheet accounts to the "Balance" account in the ledger in accordance with the continental system, which listed all balance sheet accounts with their balances; and the corresponding entries were made, beforehand, in the journal [Ledger "A" and Journal B].[9] The balance sheet in Table 1 reproduces and condenses the entry in the "Balance" account in Ledger "A" as well as the corresponding entries in Journal B. The item "All Others" on the debit side in Table 1 shows the total of 59 accounts' balances and the item "All Others" on the credit side that of 19 accounts' balances. The balance sheet shows two groups of figures, namely those presented in 1910 annual report and those resulting from a more thorough analysis of the ledger made in 1943. That means that the balance sheet was prepared in 1943. Therefore, the new DPC's staff made thorough examinations of the early accounting records of the old DPC in the early 1940s. It seems that the other five schedules covering the years 1802-1809 that were noted earlier were also products of the study of that time, although the balance sheet and the other five schedules are contained in different boxes (see References at the end of this paper).

[8] The purchase of land in 1802 may be confirmed by Journal B. The beginning of production in 1804 may be confirmed by Factory Book (see References at the end of this paper)..

[9] About the continental system, see Dicksee [1921, Chaps. V and VI]. The deed of association stipulated: "*Le Directeur de la Manufacture suivra dans les Comptes les principes de comptabilité établis en France par l'Administration des Poudres et Saltpêtres*" (The superintendent of the Manufactory will follow the principles of accounting established in France by the *Administration des Poudres et Salpêtres* in the Accounts). The *Administration des Poudres et Salpêtres* (the Office of Powder and Saltpeter) ran the state-owned powder works [Stapleton, 2006, pp.230 and 232-233]. Littleton [1933, pp.82 and 132] describes the balance account in the ledger as the old practice that was to be replaced by "separate financial statements." Jones [1985] notes the use of balance accounts by welsh industrial enterprises from the 1740s to 1830. The similar practice is noted by Edwards and Boyns [1992, p.169] concerning the Derbyshire and Nottingham Company in 1750-1765.

Table 1 (Debit Side)

E. I. DUPONT DE NEMOURS & COMPANY
BALANCE SHEET
DECEMBER 31,1809

	Figures Presented In 1910 Annual Report		Figures Resulting From More Thorough Analysis of Ledger (in 1943)	
ASSETS				
Cash		$1,911.66		$1,911.66
Accounts Receivable		31,914.11		32.318.57
Bauduy, Peter	$ 5,792.62		$ 5,792.62	
Cazenove, A. C.	3,033.36		3,033.36	
Girard, A.	5,865.52		5,865.52	
McCall, Arch	4,888.42		4,888.42	
Parent, Chas.	2,792.99		2,792.99	
All Others (various debtors with small balances)	9,541.20		9,945.66	
Bills Receivable		1,130.00		1,130.00
Inventories		31,521.95		25,808.98
Brimstone(5,179#)	336.63 (a)		336.63	
Cooperage	321.00 (b)		321.00	
Charcoal Wood	432.00 (a)		432.00	
Gunpowder(38,994#)	21,780.64 (b)		21,780.64	
Saltpetre (12,777#)	2,938.71 (a)		2,938.71	
Mortgage (c)	5,712.97 (a)		---	
TOTAL WORKING CAPITAL		$ 66,477.72		$ 61,169.21
Plants and Properties		$ 42,750.00		$ 42,750.00
Real Estate	$ 12,000.00		$ 12,000.00	
Houses	9,100.00		9,100.00	
Plants	21,650.00		21,650.00	
Mortgage (c) – "Angelica (N.Y.) property and store goods"		---		$ 5,712.97
TOTAL ASSETS		$ 109,227.72		$ 109,632.18

Original Notes:
(a) Classified as Materials totaling $9,420.31.
(b) Classified as Finished Product totaling $22,101.64.
(c) On October 31, 1834, $4,712.97 was written off to Profit and Loss; on December 31, 1850 the balance of $1,000.00 was charged to Estate of E. I. duPont.

Note: # means weight in pound.

Table 1 (Credit Side)

		Figures Presented In 1910 Annual Report		Figures Resulting From More Thorough Analysis of Ledger (in 1943)	
LIABILITIES					
Accounts Payable			$ 20,987.36		$ 23,118.50
Accrued Wages (Workmen)		$ 2,279.42		$ 2,279.42	
Bidermann, Jacques		1,043.99		1,043.99	
Broom, Jacob (balance due on purchase of land)		---		1,091.05	
Buck, A		1,545.96		1,545.96	
DuPlanty, R.		487.97		487.97	
DuPont, E. I.		11,792.69		11,792.69	
DuPont, V. deNemours & Company		149.23		149.23	
Necker, Germani		266.25		266.25	
All Others (various creditors with small balances)		3,421.85		4,461.94	
Bills Payable (3 months maturity)			6,900.00		6,900.00
Mortgage (Jacob Broom - balance due on purchase of land)			1,091.05		---
TOTAL CURRENT LIABILITES			$ 28,978.41		$ 30,018.50
Capital Stock (18 Shares at $2000. each)			36,000.00		36,000.00
	Shares	Amount			
E. I. DuPont	1	$ 2,000.00			
DuPont Farther & Company	12	24,000.00			
Jacques Bidermann	1	2,000.00			
P. Bauduy	4	8,000.00			
	18	$36,000.00			
Surplus			44,249.31*		43,613.68*
Net Profit for period 1802 to 1809, Incl.					
TOTAL LIABILITIES			$ 109,227.72		$ 109,632.18

Original Note:
* Difference between $44,249.31 and $43,613.68 or $635.63 represents interest credited during December 1810 (applicable to period 1802-1809) to various accounts (Surplus being charged).

Source: LMSS, Group 10, Series A, File 418-3, Box 392.

The net profit recorded in the 1910 annual report is the same as that recorded in the "Balance" account although the asset and liability numbers it lists are a little different. On the other hand, DPC's staff of the early 1940s determined the net profit $635.63 less than the original number in the "Balance" account. This is because they determined the number given to "All Others" under the heading "Accounts Payable" $635.63 greater than the original data. Except these two modifications, the 1943 data in Table 1 faithfully reflect the original data in the "Balance" account.

As Table 1 shows, DPC's staff of the early 1940s who prepared the balance sheet used the words "capital stock." A note made by DPC's staff that exceptionally bears a date (March 25, 1941) points out as follows: "The original organization of E. I. du Pont de Nemours & Company April 21, 1801 was more in the form of a modern corporation than that of a modern partnership."[10] The records in the ledger show these two natures [Ledger "A"]. Each partner (shareholder) had two kinds of personal accounts. One was a capital account called "account in Co." and the other a current account called "account proper." (The personal accounts under "Capital Stock" in Table 1 are accounts in Co. and the corresponding personal accounts under the headings "Accounts Payable" or "Accounts Receivable" are accounts proper). In the ledger also, an account (temporarily) recording the contributed capital was opened, which was named "Stock." At first, the "Stock" account was credited with the total capital, $36,000, with the explanation "by Sundries; Amt. Subscribed for," and the corresponding debits were made to the partners' current accounts (accounts proper). Then the "Stock" account was debited with $36,000 and the corresponding credits were made to the partners' capital accounts (accounts in Co.). All these transactions were dated April 21, 1801, the founding date. The "Stock" account temporarily symbolized a nature of corporation but was immediately cleared to zero. The capital was recorded in the partners' (shareholders') capital accounts. The "Stock" account revived at the end of the period as an account functioning as a retained earnings account. $44,249.31 on Table 1 that the 1910 annual report recorded as "Surplus" was the net profit of the first accounting period credited, on

[10] "Interest of Management in the Affairs of the Partnership of E. I. Du Pont de Nemours & Company 1801-1899" [LMSS]. The deed of association stipulated that the liability of the partners be limited to their investment in the association. (The related article is only found in "*Acte d'association*" [LMSS]). But "'Laws of Delaware, 1797,' have no provisions for Partnerships or Corporations," according to a note made by the new DPC's staff which bears a date (March 25, 1941) ["Original Partnership of 1801," LMSS]. On the part of France, its Code of Commerce was promulgated only in 1807, which recognized the following four types of business entities: *société en nom collectif* corresponding to general partnership, *société en commandite simple* corresponding to limited partnership, *société en commandite par actions* which was a type of corporation with a top executive or executives with unlimited liability and which still existed today, and *société anonyme* corresponding to the ordinary corporation which was under the government's authorization until the 1867 law.

December 31, 1809, to the "Stock" account and recorded in the "Balance" account as the "Stock" account's balance [Ledger "A"]. At the beginning of the next year, the "Balance" account was not opened. Instead, the "Stock" account served as the opening balance account before serving as the retained earnings account in the new accounting period. To the "Stock" account, under the date of January 1, 1810, the total credit accounts' opening balances were debited and the total debit accounts' opening balances were credited with the explanations "to Sundries" and "by Sundries." Each balance sheet account made a corresponding credit or debit to record its opening balance [Ledger "B"]. That process was, at the same time, the process of distributing all the net profit in the first accounting period. (Note that the "Stock" account did not function as a retained earnings account at that moment). The distributed profits were virtually credited to the partners' accounts through the above process. The credits were made not to the partners' capital accounts but to their accounts proper. The opening balance of each partner's account proper was determined (except the "DuPont, Father & Company" account that had no balance) by adding its (credit or debit) ending balance of the preceding year and its distributed profit. This process is detailed in Journal B.[11]

Table 2 reproduces the "Statement of Profit & Loss" which, as noted earlier, seems to have been prepared by the staff of the early 1940s. The statement reproduces and condenses the entries in the "Profit & Loss" account in the Ledger "A" with some modifications. It shows $65,485.66 as "Operative Earnings from Sales." That is the amount the new DPC's staff considered to be that of the profit that should have been determined in the trading account in the ledger, the "Factory" account. The profits actually determined in the "Factory" and "Profit & Loss" accounts in the ledger are referred to in the following section.

As shown in Table 2, the "Statement of Profit & Loss" is accompanied by the schedule on the distribution of the net profit which is originally recorded by entries dated January 1, 1810 in Ledger "B" and an entry in Journal B. The distribution of profit noted earlier was, in reality, made in this way. The deed of association stipulated the mode of profit distribution as follows:

[11] The account proper of only one partner (P. Bauduy) showed a debit balance, $5,792.62, at the end of the preceding year (see Table 1). As a result, the sum debited and credited to the "Stock" account on January 1, 1810 should have been $103,839.56 ($109,632.18 – $5,792.62). Journal B shows this amount, but the "Stock" account in Ledger "B" did not. One possible interpretation is that it was a simple error.

Table 2

E. I. Du PONT DE NEMOURS & COMPANY
STATEMENT OF PROFIT & LOSS
PERIOD 1802 to 1809 INCLUSIVE
(PRODUCTION COMMENCED MAY 1, 1804)

OPERATIVE EARNINGS FROM SALES (Schedule "A")		$65,485.66*
EXPENSE		
Discount on Bills Payable and Bills Receivable		3,955.90
Interest		15,773.02
DuPont, Father & Company - Interest on Shares	$4,608.75	
DuPont, Father & Company - Interest on Shares (credited to account of E. I. duPont)	3,781.77	
Jacques Biderman - Interest on Shares	1,043.99	
Peter Bauduy	1,618.55	
Peter Bauduy - Interest on Shares	2,298.63	
E. I. duPont - Interest on Shares	200.41	
E. I. duPont - Interest on Private Account	798.31	
DuQuesnoy - Interest on Shares	466.66	
Necker Germani - Interest on Shares	740.19	
Miscellaneous	215.76	
Miscellaneous Charges		2,143.06
TOTAL EXPENSE		$21,871.98
Net Profit for the Period 1802 to 1809 (Distributed as below)		$43,613.68

Original Note: * $65,485.66 equals 12.1% earned per annum on average investment of $95,612.44. (For calculation of *Average Investment* see attached statement)

DISTRIBUTION OF NET PROFIT

	SHARES OF CAPITAL	SHARES OF PROFIT				
DuPont, Father & Company	12	12/30	as	Partner		$17,445.47
Jacques Biderman	1	1/30	as	Partner		$1,453.78
Peter Bauduy	4	4/30	as	Partner	$ 5,815.15	
		3/30	as	Other	4,361.37	10,176.52
E. I. duPont	1	1/30	as	Partner	1,453.78	
		9/30	as	Manager	13,084.13	14,537.91
	18	30/30				$43,613.68

Source: LMSS, Group 10, Series A, File 418-3, Box 391.

18/30 to the "shareholders (*actionnaires*)," 9/30 to the "Head of the Manufactory (*chef de la Manufacture*)," namely E. I. du Pont, and 3/30 to "one of the architects of the Establishment (*un des auteurs du Projet et de l'Etablissement*)" who had not yet been determined. The distribution was made in conformity with this stipulation (the 3/30 were distributed to P. Bauduy). However, as noted earlier, the total distributed profit recorded in the ledger and journal is not $43,613.68 but $44,249.31. In any case, the distribution of profit was made in the way shown on the bottom of Table 2. As it shows, profit measurement for profit distribution was performed at the early old DPC. This paper is concerned with its accounting system fulfilling such a financial accounting function.

PROFIT MEASUREMENT IN A TRADING ACCOUNT

The "Factory" account of the old DPC, as a trading account, had much the same features as did the two mill trading accounts in Lyman Mills' home office ledger. Lyman Mills' home office ledger mill accounts were inventory accounts in the sense that they recorded finished goods inventories as their beginning and ending balances. Such inventory accounts were debited with manufacturing and non-manufacturing expenses and credited with sales. Credited with sales, Lyman Mills' home office ledger mill accounts recorded profit or loss and became trading accounts [Fujimura, 2007, p.171]. Dicksee [1921, p.93] described the specific feature of the trading account as "partly real and partly nominal."

Table 3

Factory Account (Condensed and Modified)
(From May 16, 1804 to December 31, 1809)

Saltpeter	$122,111.77	Sales & Others	$292,422.33
Brimstone	4,664.86	Purifying Saltpetre	2,974.43
Workmen	2,279.42	Real Estate	2,381.38
Factory Book	67,713.29	Cooperage	321.00
Others	51,750.94	Charcoal Wood	432.00
Profit	71,791.50	Gun Powder	21,780.64
	$320,311.78		$320,311.78

Note: The first entry in this account (pertaining to gunpowder delivered to sundries) is dated May 16, 1804. The entries over eleven folios in the original account are condensed into the above account by the writer. The following modifications are made to the original entries. "Gun Powder" (the finished goods inventories) is, in reality, not credited to the original account. In the above account, by crediting $21,780.64 of "Gun Powder," the profit is stated larger by the same amount than it is in the original account. That means the profit should be $50,010.86 in the original account. However, the actual debited amount of the profit was $50,010.85½. Correspondingly, the amount the writer gave to "Others" should become 51,750.94½. In fact, there is an entry recording an amount with the third decimal place among the entries included in "Others." It is the amount $50,010.85½ that is transferred from the "Factory" account to the "Profit & Loss" account. In the latter account, there is another entry recording an amount with the third decimal place. By this number, the third decimal place of the profit figure is adjusted. Therefore, the profit of $50,010.85½ may be presented as $50,010.86 from the beginning (therefore as $71,791.50 in this table). Correspondingly, the writer gave $51,750.94 to "Others."

Sources: Ledger "A" [Accession 500]; Journals A and B [Accession 500].

The same feature might be indicated to the "Factory" account in the ledger of the old DPC. The account in Table 3 is what the writer prepared by summarizing the entries in the "Factory" account in Ledger "A" from 1804 to 1809. Many of the debit entries in the "Factory" account relate to manufacturing and non-manufacturing expenses. "Gunpowder is a mixture of saltpetre, charcoal and sulphur, usually in the proportions of 75:15:10" [Crocker, 1999, p.3]. Of the three kinds of materials, saltpeter and brimstone (sulphur) consumed were debited to the "Factory" account. They were transferred from the materials inventory accounts called "Saltpetre" and "Brimstone" [Ledger "A"]. In this first accounting period, and in this accounting period only, most cash expenditures were first recorded in a blotter named "Factory Book" and mistakenly in another blotter named "Factory Building Book" for the years 1806 and 1807. These blotters detail expenditures but only the yearly totals are recorded in the journal and ledger. The total of six years is $67,713.29, which is shown as the sum of the item "Factory Book" in Table 3 [Journals A and B and Ledger "A"].[12] Among these expenditures are those concerning charcoal wood, cooperage, and wages. The expenditures related to obtaining charcoal wood (cutting, transportation, or purchase) and to cooperage are detailed in the blotters,[13] where the wages are recorded on a monthly basis. In order to record these items on an accrual basis, the charcoal wood and the cooperage (barrels and kegs) remaining unused

[12] The yearly totals are recorded in the journals and ledger as follows: on February 11,1806 for the total expenditures of each of the years 1804 and 1805, on December 31, 1808 for the total expenditures of each of the years 1806, 1807, and 1808, and on December 31 1809 for the total expenditures of the year 1809. The total of the six years amounts to $67,713.29, while the expenditures recorded in the Factory Book and Factory Building Book amount to $68,635.51. The expenditures relating to the difference between this $68,635.51 and $67,713.29 seem to have been debited to the "Factory" account separately and therefore included in "Others."

[13] Charcoal making was part of gunpowder making. Therefore, charcoal wood is recorded as materials. According to Crocker [1999, p.20], "Gunpowder was traditionally packed in oak barrels and kegs of various sizes...Most powder mills had their own cooperage, and this employed a large portion of the workforce."

were credited and the accrued wages payable ("Workmen") were debited to the "Factory" account as shown in Table 3. The counterbalancing entries were made to the accounts "Charcoal Wood," "Cooperage," and "Workmen" which were opened only for this purpose [Ledger "A"].

On the other hand, most of the credit entries in the "Factory" account relate to sales as shown in Table 3. "Gun Powder" is the ending finished goods inventory. Of the remaining four items on the credit of the "Factory" account, "Cooperage" and "Charcoal Wood" have been referred to. "Purifying Saltpetre" represents an amount charged to a personal account, "U. S. Navy Department," for purifying saltpeter, which should be deducted from the expenses debited to the "Factory" account. \$2,381.38 recorded as "Real Estate" shows the total payments made to the previous landowner and recorded in the blotters mentioned earlier. This amount was credited to offset the expenditures included in those of the item "Factory Book" in Table 3 and was transferred to the company's fixed asset account, "Real Estate."[14] Therefore, in principle, the "Factory" account records expenses on its debit side and sales and the ending finished goods inventory on its credit side in this first accounting period. Thus, the resulting profit is recorded on its debit side.

However, the actual entries in the "Factory" account in the ledger did not fully comply with the trading account format. The finished goods inventory, "Gun Powder" in Table 3, is not credited to the "Factory" account. Therefore, the actual profit debited to this account is \$50,010.86 (\$71,791.50 – \$21,780.64).[15] It is this amount that is transferred to the "Profit & Loss" account. In the account in Table 3, the writer modified the original data so as to indicate that the "Factory" account shows the complete trading account format potentially.

In Ledger "A", instead of crediting the "Factory" account with the ending finished goods inventory, a special account named "Gun Powder" was opened only to record the ending finished goods inventory amounting to \$21,780.64, and this on the debit side, of course. The counterbalancing credit was made to the "Stock" account which, as noted earlier, functioned as a retained earnings account at the close of the first accounting period. To the credit of the "Stock" account also, the debit balance of the "Profit & Loss" account, \$22,468.67, was transferred. The

[14] This "Real Estate" account corresponds to the item "Plants and Properties" in Table 1.

[15] In fact, \$50,010.85½. See the note in Table 3.

"stock" account's total credits, $44,249.31 = $21,780.64 + $22, 468.67, represents the net profit of the first accounting period. That amount is recorded as the "Stock" account's balance in the "Balance" account. It is that amount that was accepted as the net profit of the first accounting period by the new DPC's staff of around 1910 as shown in Table 1.

Therefore, the finished goods inventory produced a profit equivalent to its value only by its existence in the books. This treatment of the finished goods inventory indicates that E. I. du Pont and his bookkeeper knew that the normal or standard accounting methods of the time required that the finished goods inventory be credited to the "Factory" account in accordance with the ordinary trading account format. If they had done so, the profit determined in the "Factory" account and transferred from this account to the "Profit & Loss" account would have been $71,791.50, as Table 3 shows, and the profit transferred from the "Profit & Loss" account to the "Stock" account would have been $44,249.31, the full amount of the net profit in the first accounting period. Because they knew that was a normal practice, E. I. du Pont and his bookkeeper could treat the whole value of the finished goods inventory as profit.

The preceding discussion emphasizes the necessity of distinguishing between a normal practice and an actual practice. It may be said that the old DPC's case just seen suggests that the trading account format represented a normal practice at that time. In fact, the entries in the "Factory" account came to fully comply with the trading account format from the accounting period January 1 to August 31, 1818 [Ledger "C"].

THE OLD DU PONT COMPANY'S ACCOUNTING METHODS RECOGNIZED BY THE NEW DU PONT COMPANY'S STAFF

The entries in the "Factory" account in the first accounting period are made over eleven folios. It is not easy for an outsider to read all of these entries correctly and to determine the total sales and expenses of the period. These amounts are provided by the following schedules prepared by DPC's staff of the early 1940s: "Statement of Operative Earnings from Sales" reproduced in Table 4 and "Cost of Manufacture" reproduced in Table5. The amount of sales on the row "Grand Total" in Table 4, $251,585.74, represents the total net sales in the first accounting period. That suggests that the item "Sales & Others" in Table 3, which is created by the writer, comprises the amounts to be offset by the correcting debit entries included in the item "Others"

Table 4

SCHEDULE "A"
E. I. DU PONT DE NEMOURS & COMPANY
STATEMENT OF OPERATIVE EARNINGS FROM SALES
PERIOD 1802 TO 1809 INCLUSIVE (PRODUCTION COMMENCED MAY 1,1804)

		SALES		COST OF SALES		OPERATIVE EARNINGS FROM SALES	
	QUANTITY (POUNDS)	AMOUNT	PER POUND	AMOUNT	PER POUND	AMOUNT	PER POUND
GUNPOWDER							
Agents	332,215	$131,175.72	$.3949	$88,312.60	$.2658	$42,863.12	$.1291
Others	143,040	58,310.99	.4077	40,256.17	.2814	18,054.82	.1263
U. S. Government	54,287	20,254.50	.3731	15,871.73	.2924	4,382.77	.0807
TOTAL GUNPOWDER	529,542	$209,741.21	$.3961	$144,440.50	$.2728	$65,300.71	$.1233
GUNPOWDER (MANUFACTURED WITH U.S. SALTPETRE)							
U. S. Government	57,413	$6,184.34	$.1077	$5,264.90	$.0917	$919.44	$.0160
REMANUFACTURED GUNPOWDER_ (U.S. GOVERNMENT)							
Navy and War Departments	265,900	$21,784.19	$.0819	$24,383.64 (a)	$.0917	($2,599.45)	($.0098)
Francis Breuil, Philadelphia, Pa.	40,000	13,600.00	.3400	11,694.68 (b)	.2924	1,905.32	.0476
Samuel McCall, Philadelphia, Pa.	3,450	276.00	.0800	316.36 (a)	.0917	(40.36)	(.0117)
TOTAL REMANUFACTURED GUNPOWDER	309,350	$35,660.19	$.1153	$36,394.68	$.1176	($734.49)	($.0023)
GRAND TOTAL	896,305	$251,585.74	$.2807	$186,100.08	$.2076	$65,485.66	$.0731

Original Note: See separate statement showing details of sales by years

Original Notes: (a) Assumed to have been remanufactured without Saltpetre. (b) Assumed to have been remanufactured with Saltpetre furnished by the Company. ($8,026.59 covers cost thereof).

Source: LMSS, Group 10, Series A, File 418-3, Box 391.

Table 5 (Top Half)

COST OF MANUFACTURE
1802 TO 1809 INCLUSIVE
(OPERATIONS COMMENCED MAY 1, 1804)

DETAILS OF MANUFACTURING COSTS		
Salaries		$13,296.16
E. I. duPont (April 1, 1804 to September 30, 1809 at $1800 per annum)	$9,900.00	
Charles Dalmas (April 1, 1804 to June 30,1809 at $600 per annum)	3,100.00	
Charles Parent	161.16	
Charles Cazeau	135.00	
Wages (Including boarding of hands)		27,915.94
Saltpetre (534,511 lbs.)		122,111.77
Brimstone (99,957 lbs.)		4,664.86
All Other Costs		39,891.99
Peter Bauduy -- Commissions, etc.	9,047.90	
U. S. Government (Credit for purifying Saltpetre)	(2,974.43)	
Legal Expenses, etc. -- Charles Munns' Suit	1,135.73	
Depreciation of Factory Buildings, etc.	6,305.84	
Miscellaneous	26,376.95	
Total		$207,880.72

ALLOCATION OF MANUFACTURING COSTS

	Production Pounds	Salaries	Wages	Saltpetre	Brim-stone	All Other Costs	Total Costs	Per Pounds
GUNPOWDER								
Sales by Agents	332,215	$4,722.75	$9,915.65	$66,663.86	$1,656.94	$14,169.43	$97,128.63 (a)	$.2924
Sales to Others	143,040	2,033.45	4,269.33	28,703.10	713.42	6,100.90	41,820.20 (b)	.2924
Sales to U. S. Government	54,287	771.74	1,620.31	10,893.49	270.76	2,315.43	15,871.73	.2924
Inventory in hands of Agents December 31,1809	33,150	471.26	989.43	6,652.04	165.34	1,413.90	9,691.97 (c)	.2924
Inventory in our own Mills, etc. December 31,1809	5,844	83.08	174.42	1,172.69	29.15	249.27	1,708.61 (d)	.2924
	568,536	$8,082.28	$16,969.14	$114,085.18	$2,835.61	$24,248.93	$166,221.14	
Per Pound		$.0142	$.0298	$.2007	$.0050	$.0427		$.2924
GUNPOWDER (MANUFACTURED WITH U.S. SALTPETRE)								
Sales to U. S. Government	57,413	$816.18	$1,713.61	--	$286.35	$2,448.76	$5,264.90	$.0917
REMANUFACTURED GUNPOWDER (U.S. GOVERNMENT)								
Sales to Navy and War Departments	265,900 (f)	$3,780.02	$7,936.34	--	$1,326.19	$11,341.09	$24,383.64	$.0917
Sales to Francis Breuil, Philadelphia, Pa.	40,000 (e)	568.64	1,193.88	$8,026.59	199.51	1,706.06	11,694.68	.2924
Sales to Samuel McCall, Philadelphia, Pa.	3,450 (f)	49.04	102.97	--	17.20	147.15	316.36	.0917
	309,350	$4,397.70	$9,233.19	$8,026.59	$1,542.90	$13,194.30	$36,394.68	$.1176
GRAND TOTAL FOR THE PERIOD	935,299	$13,296.16	$27,915.94	$122,111.77	$4,664.86	$39,891.99	$207,880.72	$.2223

Original Notes: (e) Assumed to have been remanufactured with Saltpetre furnished by the Company.
(f) Assumed to have been remanufactured without any Saltpetre.

Table 5 (Bottom Half)

Saltpetre consumed	534,511	lbs.
Less Estimated loss in refining, etc. (14.61%)	78,109	"
Assumed quantity of Saltpetre actually used (75% of Gunpowder produced)	456,402	"
Brimstone	99,957	"
Percent Brimstone to Gunpowder Manufactured	10.69%	

SUMMARY

	SALES		COST OF
	POUNDS	AMOUNT	SALES
GUNPOWDER			
Agents	332,215	$131,175.72	$88,312.60 *
Others	143,040	58,310.99	40,256.17 **
U. S. Government	54,287	20,254.50	15,871.73
	529,542	$209,741.21	$144,440.50
GUNPOWDER (MANUFACTURED WITH U. S. SALTPETRE)			
U. S. Government	57,413	6,184.34	5,264.90
REMANUFACTURED GUNPOWDER (U. S. GOVERNMENT)			
Navy and War Departments	265,900	$21,784.19	$24,383.64
Francis Breuil, Philadelphia, Pa.	40,000	13,600.00	11,694.68
Samuel McCall, Philadelphia, Pa.	3,450	276.00	316.36
	309,350	$35,660.19	$36,394.68
	896,305	$251,585.74	$186,100.08

Original Notes:

* COST OF SALES BY AGENTS			** COST OF SALES TO OTHERS		
Cost as above (a)		$97,128.63	Cost as above (b)		$41,820.20
Adjustment -- Difference between value at which inventory in hands of agents 12/31/09 of 33,150 lbs. was set up on books, viz.			Adjustment -- Difference between value at which inventory on hand 12/31/09 of 5,844 lbs. was set upon book, viz.		
$.5583 per lb.	$18,508.00		$.5600 per lb.	$3,272.64	
and actual cost thereof as above, $.2924 (c)	9,691.97	(8,816.03)	and actual cost thereof as above, $.2924 (d)	1,708.61	(1,564.03)
		$88,312.60			$40,256.17

Source: LMSS, Group 10, Series A, File 418-3, Box 391.

created also by the writer, which are often referred to as "return entries" in the ledger [Ledger "A"].[16] The data shown under the

[16] R.T. Johnson [1989, p.70] notes: "Initially, the record keepers credited all powder distributions directly to the 'Factory account.' For direct sales to customers or company principals, this constituted an accurate recognition of revenue.... Transfers of powder to agents for disposal on behalf of the company did not constitute a completed earnings process, however, and therefore should not have been credited to the 'Factory' account until the agents sold the powder to a third

heading "Details of Manufacturing Costs" in Table 5 are, except "Depreciation of Factory Building, etc.," the expenses incurred in the first accounting period.

Tables 4 and 5 show that DPC's staff of the early 1940s prepared these tables supposing that the ending finished goods inventories were credited to the "Factory" account. Because there are no beginning inventories in this first accounting period, the cost of the finished goods sold of each category, which are recorded in Table 5 under the heading "Allocation of Manufacturing Costs," must represent each category's cost of sales to be recorded in Table 4. However, as to the sub-categories "Sales by Agents" and "Sales to Others" within the category "Gunpowder," further calculations for obtaining their costs of sales are made in the original notes at the bottom of Table 5. In these calculations, each cost of sales is obtained by subtracting from the real cost of sales the difference between the estimated price and the cost of the related finished goods inventories. This process of computing the pretended cost of sales indicates that DPC's staff of the early 1940s made the calculations supposing that the ending finished goods inventories were credited to the "Factory" account. In this supposition, the difference between the higher estimated price and the cost of each inventory produces profit. To record the profit produced in this way, DPC's staff of the early 1940s reduced the cost of sales by the profit for each of the two sub-categories. These modified numbers are reproduced in Table 4. Thus, in Table 4 profit calculation in the framework of the trading account is reconciled with the modern profit calculation formula, namely sales minus cost of sales equals profit. That means that the profit recorded on the row "Grand Total" in Table 4 must agree with the profit debited to the trading account in Table 3. However, they are a little different. The difference, \$6,305.84, is explained by the fact that the depreciation expense, \$6,305.84, is included in the "Manufacturing Costs" in the schedule in Table 5, while it is charged not to the "Factory" account but to the "Profit & Loss" account in the ledger [Ledger "A"].[17] It seems certain that DPC's staff of the early 1940s supposed the same trading account format as does Table3 in under-

party." R. T. Johnson [1989] does not refer to the related correcting entries. Of course, other kinds of correcting entries were also made.

[17] It seems that this depreciation does not mean periodical depreciation to be charged as manufacturing expense. It rather relate to revaluation of the fixed assets. The old DPC did not perform periodical depreciation even in its last years [Ledgers N0. 10 and No.1]. Lyman Mills executed replacement accounting [Fujimura, 2004]. The writer supposes the old DPC did the same.

standing the entries in the "Factory" account in the ledger.

The preceding observation suggests that DPC's staff of the early 1940s knew the traditional accounting system very well. The trading account in Table 3 represents a normal practice in the traditional accounting system. The accounting system of the old DPC should be understood on the supposition that its "Factory" account took the complete trading account format shown in Table 3. The schedules in Tables 4 and 5 well explain cost and profit calculation performed in this complete trading account. Further, the cost records in Table 5 show the specific features of the costing for financial accounting purposes made in the trading account.

First, the items listed under the heading "Details of Manufacturing Costs" suggest that the "manufacturing costs" include both manufacturing and non-manufacturing costs. The salaries of E. I. du Pont and legal expenses may be regarded as general and administrative expenses, while the commissions of Peter Bauduy are selling expenses. That indicates that the item "Miscellaneous" includes other non-manufacturing expenses as well as factory overhead, other than the expenses for charcoal wood and cooperage. In any case, both manufacturing and non-manufacturing costs are recorded in the "Factory" account, and in such an account profit is calculated. Manufacturing and non-manufacturing costs were not treated differently in profit calculation in traditional accounting.

In passing, the above suggests that "cost of sales" mentioned earlier was not cost of sales in the strict sense. On the other hand, the profits determined in the schedule in Table 4 and the "Factory" account may be regarded as operating profit in the broad sense.

Second, the data on the costs by category under the heading "Allocation of Manufacturing Costs" indicate that costs, more specifically conversion costs, are assigned to only finished goods sold or inventoried. In other words, work-in-process inventories (as partly completed units) are not the object of costing. That suggests that the work-in-process inventories are valued at materials costs alone and recorded in the materials accounts, namely in the accounts "Saltpetre," "Brimstone," and "Charcoal Wood." In fact, the old DPC had no account specifically devoted to record work-in-process inventories.[18]

[18] Only one time, work-in-process inventories (as partially completed units) were recorded distinctively in the books at the close of the accounting period on June 30, 1814. After December 31, 1809, the old Du Pont Company closed the books on June 30, 1814, December 31, 1814 and December 31, 1815. These periods, namely from January 1, 1810 through December 31, 1815, were covered by the other set of schedules noted at the outset of this paper. A compound entry

Third, different estimated prices are given to the two categories of finished goods inventories in the calculations of cost of sales made in the original notes at the bottom of the schedules in Table 5. The ledger and journal [Ledger "A" and Journal B] record only the total weight and amount of the two categories, as shown in the balance sheet in Table 1. DPC's staff of the early 1940s drew these prices from the records in Waste Book B. Therefore, the prices shown there are those given by the old DPC. It may be presumed that the old DPC determined these prices based on market prices. The original notes at the bottom of the schedule in Table 5 show that the inventory "in hands of agents" on December 31, 1809 is estimated at 55.83 cents per pound and the inventory on the factory site for "Sales to Others" on the same date at 56 cents per pound. Although these prices are much higher than the related sales prices recorded in Table 4 that are the averages in six years, they seem to reflect the market prices of gunpowder at the end of 1809. According to one of the six schedules recording detailed data on sales for the years 1804 to 1809 which will be treated in the following section and

made on the credit of the "Factory" account on June 30, 1814 was detailed by the corresponding entry in the journal where a record of partially completed units is found. There, as the inventories at the end of the period, "GP Unfinished in the mill @48 Cts $7,603.20" and "GP in the magazine ready put up @52Cts $7,852.00" are recorded together with "GP in the hands of several agents" that was valued at 56 cents per pound [Journal "B"]. ("GP" is, of course, gunpowder). However, it should be noted that not only "GP in the magazine" but also "GP Unfinished" were valued by reference to market prices. According to the schedule for the years 1810-1815 corresponding to that in Table 4 [LMSS], the average sales price per pound of "Gunpowder" is $0.5616 and according to the schedule for the years 1810-1815 corresponding to that in Table5 [LMSS], the average cost per pound of the category "Gunpowder" is $0.4278. Therefore, the partially completed units were valued higher than the cost of the finished gunpowder and may be presumed to have been valued based on or considering the market prices of the completed gunpowder. R. T. Johnson [1989, p.77] highlighted the above journal entry and wrote as follows: "These nineteenth-century record keepers even went so far as to value what constituted 'Work-in-Process Inventory,' and recognized completion of this in-process powder in ensuring periods." However, the fact that work-in-process inventories were recorded does not come as a surprise. They existed actually and physically. The question is how they were recorded. As noted earlier in the text, partially completed units were valued at their materials costs and recorded in the materials accounts in general (R. T. Johnson overlooked this fact). In the case noted in this note, the partially completed units were valued at market and recorded in the "Gunpowder Outstanding" account, which was opened in Ledger "B" to record the finished goods inventories. It should be noted that the recording of partially completed units on June 30, 1814 had no influence on the schedules covering the years 1810 to 1815. They have the same formats as the previous schedules do.

its successor for the years 1810 to 1815, the annual average sales price of the category "Sales by Agents" is 49.68 cents per pound for the year 1809 and 58.09 cents per pound for the year 1810; and that of the category "Sales to Others" is 49.80 cents per pound for the year 1809 and 56.35 cents per pound for the year 1810.[19] Those annual average sales prices for the years 1809 and 1810 suggest that the old DPC estimated the inventory values at the end of the year 1809 based on the market prices at that moment. Therefore, the finished goods inventories credited to the "Factory" account are not valued at cost but based on market prices, at a much higher price than cost in this case. However, the entry to record a write-up of the finished goods inventories is not made in the ledger. The old DPC gave the value higher than cost to the finished goods inventories without recording a write-up. The finished goods inventories were valued with a dollar amount that originated outside the books of account.

The above three specific features found in the records of the trading account show fundamental differences between the traditional accounting system and the modern accounting system of today that Johnson and Kaplan [1987] characterize using the terms "integration " and "inventory costing." The practice noted as the third point above is what Johnson and Kaplan [1987, p.131] note as the practice that was opposed to "integration" and "inventory costing." Johnson and Kaplan note only that practice as the practice against "integration" and "inventory costing" found in the traditional accounting system. However, it should be noted that not only the third point but all the three points above are opposed to inventory costing. In inventory costing for financial accounting purposes, only manufacturing costs are regarded as an asset when they are incurred. As noted as the first point, manufacturing and non-manufacturing costs were not treated differently in the trading account. The differentiation between inventoriable costs and period costs did not exist at the old DPC's accounting system. As noted as the second point, conversion costs are not assigned to work-in-process inventories (as partly completed units).[20] That indicates that costs were not regarded as an asset when they were incurred. The third point indicates the same thing. The finished goods inventories were valued based on market prices, at a price much higher than

[19] "Sales of Gunpowder and Remanufactured Gunpowder, Period May 1, 1804 to December 31, 1809, Inclusive" and "Sales of Gunpowder and Remanufactured Gunpowder, Period 1810-1815 Inclusive" [LMSS].

[20] This fact itself was perceived by Johnson [1972, p.470].

costs, without making a write-up. That indicates that costs were not regarded as an asset when they were incurred. All the three specific features of traditional accounting found in the old DPC's accounting system show that inventory costing for financial accounting purposes that supports today's integrated accounting system was lacking at the old DPC.

At the same time, the three specific features suggest the presence of a consistent logic in cost and profit calculation made in the trading account. As noted above, the finished goods inventories were valued based on market prices. That means that profit was computed on the basis of production. Not profit on sales but profit on production was computed in the trading account. In this profit calculation, the differentiation of inventoriable costs and period costs makes no sense. Therefore, both manufacturing and non-manufacturing costs were treated in the same way in the trading account. Both constituted the costs of finished goods. That means that finished goods inventories were valued at the total of both costs when they were valued at cost.[21] It is suggested by the fact that the costs allocated to the inventories in Table 5 comprise both manufacturing and non-manufacturing costs. Further, the fact that conversion costs were assigned to only finished goods means that the costs incurred during the year represent the costs of the finished goods completed during the year. Therefore, the manufacturing and non-manufacturing costs recorded in the trading account, which are shown in Table 5, represent both the costs incurred during the year and the costs of finished goods completed during the year. These costs were matched against the revenues they generated. Profit on production was measured in that way in the trading account.

ADDITIONAL COMMENTS ON THE OLD DU PONT COMPANY'S ACCOUNTING SYSTEM

Although in a different way from that of today's methods,

[21] Manufactured inventories may have been valued at cost. According to Fujimura [2000], at Schneider and Company, a French company, (1) work-in-process inventories in job costing were valued at full cost including both manufacturing and non-manufacturing costs; (2) work-in-process inventories in process costing recorded as departmental finished goods were valued at full cost including both manufacturing and non-manufacturing costs; and (3) work-in-process inventories in process costing to be treated as partially completed units were valued at material costs only. Some of the complete records concerning job costing that were used to value inventories are reproduced in Fujimura [2002].

the old DPC, in its early years, grasped the costs incurred and used the cost data to compute profit. However, aside from balancing the accounts on February 11, 1806 without accompanying profit measurement, the old company did not close the accounts until the end of the first term of association. It did not close the books annually despite the stipulation of the deed of association noted earlier. That did not mean, however, the old company was not able to close the books annually, as will be seen from now.

As indicated by an original note in the schedule in Table 4, a schedule recording annual sales was prepared by DPC's staff of the early 1940s, which is entitled "Sales of Gunpowder and Remanufactured Gunpowder." Table 6 reproduces only part of that schedule. As this table suggests, regarding the sub-category "Agents" within the category "Gunpowder," sales are recorded for each individual agent. Although omitted, the data on all the categories and sub-categories corresponding to Table 4 are recorded in the schedule. In Table 6, only the data of the years 1804 and 1809, other than those of the total of the six years, are reproduced, partly. On the part of the schedule, of course, the full data of all the six years from 1804 to 1809 are recorded. More importantly, there is a set of schedules in the Hagley Museum and Library named "Powder Sales Book" in the catalogue and covering the years 1804 through 1814 that the new company's staff seem to have relied on in preparing the schedule partly reproduced in Table 6. All the data in the schedule "Sales of Gunpowder and Remanufactured Gunpowder" are found in the old company's set of schedules that are much more detailed.[22] A handwritten note on the cover of the old company's set of schedules suggests that the schedules were filed to the Delaware Court of Chancery for the suit of E. I. du Pont and others with Peter Bauduy on April 14, 1818. Therefore, the schedules were prepared after the related accounting periods passed and to cope with litigation. Nonetheless, the schedules prove that the old company was capable of preparing annual data. That indicates that the old company was capable of closing the books annually. Only it did not do so.

[22] The new company's staff made one modification to the original: the $10,085.15 sale in 1809 by McCall is recorded as that of 1810 in the original. It seems that the data by category and subcategory in the columns "Quantity" and "Sales" in Table 4 were obtained from this old company's schedule.

Table 6

SALES OF GUNPOWDER AND REMANUFACTURED GUNPOWDER PERIOD MAY 1, 1804 (DATE PRODUCTION COMMENCED) TO DECEMBER 31, 1809, INCLUSIVE

	TOTAL			1804			1809		
	Pounds	Amount	Per Pound	Pounds	Amount	Per Pound	Pounds	Amount	Per Pound
GUNPOWDER AGENTS									
Buck, A.	550	$ 184.04	$.3346						
Bowden R. & Company	8,050	2,432.13	.3021				125	$ 60.94	$.4875
Brujeire & Teisseire	12,475	5,435.90	.4357				8,675	4,230.96	.4877
Cazenove, C. A.	24,390	10,163.13	.4167				14,650	6,784.06	.4631
Delaire & Canut	5,750	2,545.26	.4427				4,450	1,988.06	.4468
Dowes, I. D. P.	1,350	465.79	.3450						
Drummond, R.	3,500	1,630.51	.4659				3,500	1,630.51	.4659
DuPont, V. deNemours & Co.	2,400	787.52	.3281						
Girard, A.	92,975	33,779.65	.3633				19,625	9,592.74	.4888
Gundacker, J.	1,656	559.06	.3376						
Hancock, John	11,750	5,013.57	.4267				5,350	2,999.16	.5606
Hastings, S.	1,104	409.97	.3713						
LaForest, A.	13,715	5,829.36	.4250				3,375	2,017.69	.5978
McCall, Arch	108,700	46,388.99	.4268	13,250	$ 5,137.92	$.3878	18,500	10,085.15	.5451
Mein & Rogers	1,650	566.70	.3435				1,650	566.70	.3435
Mitchell & Sheppard	11,550	4,036.49	.3495	950	365.00	.3842			
Parent, Chas.	2,200	1,080.00	.4909						
Pitray, L. A.	2,250	1,032.37	.4588				2,250	1,032.37	.4588
Shewell, Thos.	12,500	4,478.27	.3583				1,125	384.40	.3417
Snydan & Wickoff	3,725	1,035.62	.2780						
Stoney, J.	2,725	837.25	.3072						
Sullivan, J. & Company	1,000	255.97	.2526						
Thurston, J.	1,325	457.19	.3450						
Watkinson & Company	2,050	714.90	.3487						
Whipple, John	2,875	1,056.10	.3673						
TOTAL AGENTS (25)	332,215	$131,175.72	$.3949	14,200	$ 5,502.92	$.3875	83,275	$41,372.74	$.4968
OTHERS	143,040	58,310.99	.4077	12,000	4,632.25	.3860	23,356	11,630.85	.4980
GRAND TOTAL	896,305	$251,585.74	$.2807	26,200	$10,135.17	$.3868	205,431	$63,850.62	$.3108

Note: The original schedule records the data of each year from 1804 through 1809. The data after the subcategory "Others" are omitted except those concerning "Grand Total." The original schedule shows each agent's office's location as follows: Buck, A., Fredericksburg, Va.; Bowden, R. & Company, Norfolk, Va.; Brujeire & Teisseire, Philadelphia, Pa.; Cazenove, C. A., Alexandria, Va.; Delaire & Canut, Charleston, S. C.; Dowes, I. D. P., Albany, N. Y.; Drummond, R., Norfolk, Va.; DuPont, V. deNemours & Co., New York, N. Y.; Girard, A., New York, N. Y.; Gundacker, J., Lancaster, Pa.; Hancock, John, Boston, Mass.; Hastings, S., Boston, Mass.; LaForest, A., Richmond, Va.; McCall, Arch, Philadelphia, Pa.; Mein & Rogers, Newport, R. I.; Mitchell & Sheppard, Baltimore, Md.; Parent, Chas., New Orleans, La.; Pitray, L. A., Charleston, S. C.; Shewell, Thos., Philadelphia, Pa.; Snydan, & Wickoff, New York, N. Y.; Stoney, J., Charleston, S. C.; Sullivan, J. & Company, Boston, Mass.; Thurston, J., Newport, R. I.; Watkinson & Comapny, Hartford, Conn.; Whipple, John, Providence, R. I.

Source: LMSS, Group 10, Series A, File 418-3, Box 391.

The fact that the books were not closed annually did not mean that accounting was not important for management, either. Based on a letter from E. I. du Pont to certain merchants dated March 18, 1807, R. T. Johnson [1989, p.77] made the following remarks: "E. I. did recognize that fluctuations in the prices of at least one raw material, saltpetre, influenced the minimum amount that could be charged for the final product. They must have had some concept of the underlying costs, therefore, even though there is no clear indication of this fact." The letter she quoted reads: (E. I. du Pont wished) "to keep our prices as low as the price of saltpetre can afford us." R. T. Johnson presumed that E. I. du Pont had had the knowledge of the cost of gunpowder although she could not find out evidence about the matter. Evidence that E. I. du Pont could have a precise knowledge of the cost of his product was given by the "Factory" account and the schedule in Table 5 which have been examined.

The fact that an industrial enterprise recorded costs and used the cost data to compute profit indicates that that enterprise grasped the unit costs of its products. Therefore, E.I. du Pont could ask the lowest possible price to buyers. In doing so, estimating unit costs based on the fluctuating price of a major material, saltpeter, was an effective way. In fact, the cost data in Table 5 indicate that saltpeter accounted for more than half of the cost of gunpowder; and in the first accounting period, the price of the saltpeter purchased by the old company fluctuated between $0.1287 and $0.4086 per pound (in terms of annual average prices, it is between $0.1642 and $0.3647).[23] It is very comprehensible that, in that situation, E. I. du Pont or his accountant was making speedy unit cost estimation in that way. It is also comprehensible that the records of such estimations do not survive.

E. I. du Pont's act that the above letter show suggests how a competitive market was working at that time. An industrial enterprise, a price-taker, well grasped the unit costs of its products and asked profitable and salable prices to buyers who bade prices in return. And prices were eventually determined by market forces. The fact that E. I. du Pont grasped unit costs indicates that a competitive market existed at that time.

CONCLUSION

The old DPC's accounting system that has been seen shows

[23] "Saltpetre (Ledger Account) 1804 to 1815" [LMSS].

that there existed a complete accounting system comparable to but different from the modern accounting system of today that Johnson and Kaplan [1987, pp.130-31] characterize using the terms "integration" and "inventory costing." The specific features of costing for financial accounting purposes of that traditional accounting system and its peculiar logic in cost and profit calculation have been detailed. The discovery of this another complete accounting system leads to a new understanding of accounting history, about which some discussion will be made.

The old DPC, in the beginning, ran only a small factory equipped with water-powered machinery and employing less than thirty workers for powder-making,[24] the cooperage workers aside. It was a single-unit, non-integrated industrial enterprise. The DPC case that has been seen seems to show a natural outcome of the application of the double-entry bookkeeping system to industrial accounting. In fact, it was the use of double-entry bookkeeping that enabled DPC to record the costs incurred and to use the cost data to measure profit. Let us review the DPC case from this perspective.

First, it must be confirmed that DPC's accounting system complied with the double-entry methods. As has been seen, the expenses and revenues were entered in the following accounts: the "Factory" and "Profit & Loss" accounts. Although the "Factory" account functioned as a trading account from the first accounting period, it was from the period January 1 to August 31, 1818 that this account came to take the complete trading account format. Here, for simplicity, the "Factory" account is supposed to take the complete trading account format from the first accounting period. Under this supposition, the "Factory" account and "Profit & Loss" account should have been working as follows. The manufacturing and non-manufacturing expenses were debited to and the related sales revenues and inventories were credited to the "Factory" account, the resulting profit being debited. The profit thus determined in this account was transferred to the "Profit & Loss" account. In the latter account, as well as the profit transferred, other expenses and revenues were recorded. The net profit thus determined in this account was transferred to the "Stock" account that functioned as the re-

[24] The list of buildings and equipment of the first works was recorded in Waste Book B as part of the "Inventory" on June 30, 1814. The entry on the accrued wages payable on December 31, 1809 in Journal B records twenty workers. Twenty-eight workers are recorded in "Balance due to Workmen on the 31st December 1810" in Day Book.

tained earnings account. The net profit recorded in the "Stock" account was transferred to the "Balance" account to which all the balance sheet accounts were closed.

It should be noted that the "Balance" account balanced because the "Stock" account was closed to this account. The net profit recorded in the "Balance" account was not determined by the comparison of the assets and liabilities it recorded. The net profit was transferred from the "Stock" account. The net profit recorded in the "Stock" account was the result of the revenue and expense transactions recorded in the "Factory" and "Profit & Loss" accounts. Therefore, it may be said that the presence of the "Balance" account in the ledger gives evidence that DPC's accounting system was in accordance with the double-entry system.

Second, the preceding discussion indicates that DPC's double-entry system was realized by the presence of the following two accounts, namely the "Factory" and "Profit & Loss" accounts. Besides, the following accounts were used to record expenses to the "Factory" account on an accrual basis: the "Saltpetre," "Brimstone," "Charcoal Wood," "Cooperage," and "Workmen" accounts. Among them, four accounts are inventory accounts. The remaining "Workmen" account is a liability account. There was no expense account. Accounts recording revenues and expenses were a rarity at DPC. This situation suggests that the DPC case may represent a primitive state of the double-entry accounting system applied to the industrial enterprise or nearly so.

Third, it is visible that the "Factory" account, a trading account, played a critical role in making DPC's double-entry system work. The trading account is an inventory account in which costs are matched against revenues. Such a special account was used. The trading account recorded both manufacturing and non-manufacturing costs without making distinction between them and computed profit using these cost data. That was the natural outcome of the application of the double-entry system to industrial accounting.[25]

[25] In commercial accounting, a merchandise inventory account served as a trading account. This practice may date back to the double-entry system that Paciolo described. According to the English translation of Paciolo's text compiled by Littleton [1933], Paciolo recommended that a sale of merchandise be credited to the related merchandise account (p.75) and that a loss be credited and a profit be debited to this inventory account "in order to balance it" (pp.67 and 68). That practice that an inventory account serves as a trading account may date back to Paciolo's text.

The old DPC case indicates that double-entry bookkeeping was readily applicable to not only commercial accounting but also industrial accounting. In fact, Garner [1954, p.8], quoting F. Elder's *Glossary of Mediaeval Terms in Business, Italian Series, 1200-1600*, published in 1934, notes as follows: "As early as 1431, some 63 years before Paciolo published the first printed text on double entry bookkeeping, one finds 'rather complex sets of books in use in Medici industrial partnership.'" The complex sets of books were kept in accordance with the double entry methods from 1441 [Garner, 1954, p.9]. Solomons [1968, p.4] notes that "the period from the early fourteenth century down to the third quarter of the nineteenth century is largely, though by no means only, concerned with bringing the records of industrial activity within the compass of double-entry bookkeeping." More recently, Jones [1985, chap. IV] presents early examples of double-entry industrial accounting in Britain, the Cyfarthfa Iron works in 1791-1798 and the Mona Mine in 1829-1830. Another example in Britain is presented by Stone [1973] as to the Charlton Mills in 1810 and after.[26] Edwards and Boyns [1992] present much earlier examples, charcoal ironmaking companies in the region of Sheffield during the period 1690-1783. The accounting

[26] The two authors have searched for only cost and management accounting aspects in earlier industrial accounting. As a result, they have failed to perceive its specific features epitomized by the trading account, which this paper has illuminated concerning the old DPC. However, some of the aspects found in the old DPC may also be drawn from their works. For example, from Jones [1985, pp.131-133], the presence of eight trading accounts (Cyfarthfa Furnace, New Blast Furnace, Bar Iron, Castings, Blooms, Refining Furnace, Rolling Mill, and Finers Metal) are found in the Cyfarthfa Ironworks in 1791-1798. Stone [1973] calls all the thirteen work-in-process and one warehouse accounts at the Charlton Mills trading accounts. However, only the warehouse account is a real trading account. Although the entry of this account is described only partly, it may be presumed that the warehouse account was an inventory account recording both materials and finished goods inventories and that this inventory account functioned as a trading account. The general expenses charged to the thirteen work-in-process accounts included "advertising, legal expenses, taxes and London sales allowance" [Stone, 1973, p.77]. Therefore, manufacturing and non-manufacturing expenses were not differentiated. Further, the figure reproducing one of the work-in-process inventory account shows that partially completed units were valued at materials cost only [Stone, 1973, p. 77]. The three accounts (the Smithy, Foundry, and Fitting accounts) in the double-entry ledger of Soho Foundry in the late 1790s that Williams [1997, p.175] presents are trading accounts. The profit or loss determined in each of these accounts was "transferred to the general profit and loss account" [p.174]. This Soho Foundry's accounting system is not perceived by Fleischman and Parker [1997, chap. 7] who concentrate on accounting records other than ledgers and journals in their research into British accounting practices in the 1760-1850 period.

system there was taken over by successive entities at Staveley and was in use to 1990 [Edwards, Boyns, and Anderson, 1995, pp.11, 17, and 36].

The above authors do not notice that the accounting records they examined may show the presence of another complete accounting system contrasting with today's integrated accounting system. This represents the existing state of accounting history research. The historical existence of another complete accounting system in earlier times remains unknown. This paper has tried to fill this gap in accounting history. This paper has revealed that double-entry bookkeeping, together with the trading account, enabled the industrial enterprise to record costs and to use cost data to compute profit for financial accounting purposes, and this in different way from today's. The traditional accounting system made in this way existed in the time of the Industrial Revolution and may have existed much earlier. It is this traditional accounting system that was replaced by the modern accounting system of today which Johnson and Kaplan [1987] characterize by "integration" and "inventory costing." Based on this finding, a new understanding of accounting history may be presented. Accounting history may be described as evolution of the traditional accounting system made through double entry bookkeeping in which the trading account was of vital importance and the transition from that traditional accounting system to the modern integrated accounting system supported by inventory costing. In both the traditional and modern accounting systems, cost were and are recorded and cost data were and are used to measure profit for financial accounting purposes, but in different ways.

Finally, it seems useful to make the following additional comments. First, this paper has reconfirmed that "inventory costing" supporting "integration" was crucial in making the modern accounting system of today, which Johnson and Kaplan [1987] noted. The transition from the traditional accounting system to the modern integrated accounting system should have occurred sometime after 1900. It seems worthwhile considering the historical significance of accounting theories such as historical cost, the matching concept and the entity theory in this context.[27]

Second, the cost and profit calculations made at the old DPC in the early nineteenth century may illustrate the price-

[27] About the history of these accounting theories, see Previts and Merino [1998, Chap.6].

taker's accounting which Adam Smith and economists who followed him saw in constructing their theories. Although he acknowledges that the American textile manufacturers in the first half of the nineteenth century "relied on double-entry bookkeeping," Chandler [1977, pp.69-71] presents a negative view on their ability of costing. Further, he explains the reason why the textile manufacturers were not interested in cost as follows: "there was little pressure on the textile manufacturers to improve cost data," for "the manufacturers had as little control over the price of cotton as they did over that of their finished cloth" [Chandler, 1977, p.71]. The preceding quotation shows that Chandler thinks price-takers do not need reliable cost data, although price takers need to know their cost of production to measure their financial performance in their profit-seeking activities. Although Chandler's error in fact recognition had been soon made clear owing to Porter [1980],[28] his erroneous view on the price-taker's accounting was backed by Johnson and Kaplan [1987, pp.30-31] and still remains to be criticized by no one but Fujimura [2000]. This paper has made clear that Chandler's theory presented in his book *Visible Hand* is based on the erroneous understanding of the price-taker's accounting. An overall revision of Chandler's theory is necessary.

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Longwood Manuscripts, Group 2

"*Acte d'association*." The full title is "*Acte d'association d'une Manufacture de Poudre de Guerre et de Chase dans les Etats Unis d'Amerique* (Deed of association of a Gun and Sporting Powder Works in the United States of America)," Box 4. (This is a hand-transcribed copy of one of the originals

[28] Of the accounting records that Chandler [1977, p.528 (note 60)] examined to present his view, those of the Boston Manufacturing Company and the Lawrence Manufacturing Company are used by Porter [1980], who concludes that "sophisticated costing" were executed at these companies. Based on the data presented by Porter [1980] and Hoskin and Macve [1996], Fujimura [2000, pp.28-31] notes that the Lawrence Manufacturing Company recorded costs including nonmanufacturing costs in its trading account in the ledger.

belonging to one of the original partners or shareholders, Necker Germany of Genève).

LMSS (Longwood Manuscripts, Group 10, Series A)
A set of statements for the years 1801-1809
Balance Sheet, Dec. 31, 1809, File 418-3, Box 392.
Statement of Profit & Loss, 1802-1809 Inclusive, File 418-3, Box 391.
Schedule "A", Operative Earnings from Sales, 1802-1809 Inclusive, id.
Cost of Manufacture, 1802-1809 Inclusive, id.
Sales of Gunpowder and Remanufactured Gunpowder, Period May 1, 1804 (Date Production Commenced) to December 31, 1809, Inclusive, id.
Average Investment Calculation for Period 1810 to 1809, Inclusive, id.
A set of statements for the years 1810-1815
Balance Sheet, Dec. 31, 1815, File 418-3, Box 392.
Statement of Profit & Loss Period 1810-1815 Inclusive, id.
Schedule "B" Statement of Operative Earnings from Sales, Period 1810 to 1815 Inclusive, File 418, Box 383.
Cost of Manufacture, 1810-1815 Inclusive, id.
Sales of Gunpowder and Remanufactured Gunpowder, 1810-1815 Inclusive, id.
Average Investment Calculation for Period 1810-1815, Inclusive, id.
"Articles of Partnership." The full title is "Original Articles of Partnership of E. I. Du Pont & Co. entered into at Paris, April 21, 1801," File 418-3, Box 391. (It is the translation of some original and is a little abbreviated).
"Interest of Management in the Affairs of the Partnership of E. I. Du Pont de Nemours & Company 1801-1899," File 418-3, Box 392.
"Original Partnership of 1801," File 418-3, Box 392.
Saltpetre (Ledger Account) 1804 to 1815, File 418-3, Box 392.

Accession 500 (Accession 500, series I)
Factory Building Book, No.848.
Day Book, 1804-1810, No.849.
Factory Book, 1804-1810, No.850.
Waste Book B, 1810-1816, No.862.
Journal A, 1801-1808, No.877.
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Journal, 1832-1834, No.891.
Journal No.1, 1900-1903, No.922.
Ledger "A", 1801-1810, No.934.
Ledger "B", 1810-1816, No.935.
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Ledger "D", 1818-1823, No.937.
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Ledger "H", 1834-1838, No.941.
Ledger "I", 1839-1844, No.942.
Ledger "J", 1844-1846, No.943.
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In most countries, sporting organisations are economically and socially important. Sports such as basketball, cricket, football (in its various forms), golf and hockey contribute significantly to shaping the cultures, communities and societies across the globe. While covering a diversity of activities, sport is likewise delivered and managed by means of a plethora of organisational structures from large for-profit corporate bodies to local volunteer-based community clubs. However, one factor common to all sporting organisations, both now and in the past, is the need to account and to be accountable.

A special issue of *Accounting History* on the above titled theme is scheduled to be published in the first half of 2015.

Topics for this special issue may include, but are not limited to, areas such as:

- Accounting practices in sport and/or sporting organisations
- Accountability and reporting by sporting organisations
- The diverse sources of funding in sport and their consequences for shaping notions of accountability and success
- The role of accounting in shaping the development of sporting organisations, or sports as a whole
- The interplay between sport and accounting and the development of national culture, or community social capital
- The relationship between financial ("off-field") success and sporting ("on-field") success
- Accountants' contribution to sport, or the influence of sports or sporting culture on accountants and accounting practice
- Creative accounting, fraud and accounting scandals in sport

Potential contributors are encouraged to interpret the theme broadly using diverse theoretical and methodological perspectives. Submissions are particularly encouraged which explore the multiple, complex and disconnected factors shaping accounting's past in sport and which seek to identify the impacts of accounting on organisational and social functioning. Likewise, papers published in this special issue need not be constrained by focusing only on large, national or international sports and organisations. Contributions which focus on accounting and sport in local settings are also welcome.

Submissions must be written in English and forwarded electronically to the guest editors by 30 September 2013. Manuscripts will be subject to the usual double blind review process of *Accounting History*.

Guest editors:

Potential contributors are invited to contact the guest editors to discuss their proposed topics.

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THE VICTORY OF THE PRUSSIAN RAILWAY "DYNAMIC" ACCOUNTING OVER THE PUBLIC FINANCE AND PATRIMONIAL ACCOUNTING MODELS (1838-1884): AN EARLY ILLUSTRATION OF THE APPEARANCE OF THE SECOND STAGE OF CAPITALIST FINANCIAL ACCOUNTING AND A TESTIMONY AGAINST THE AGENCY AND THE MARKET FOR EXCUSES THEORIES

Abstract: The history of accounting for private railway companies in Germany shows that these companies played a major role in the diffusion of historical cost accounting principles and gave birth, together with big other joint stock companies, to the "dynamic" or second stage of capitalist accounting, at least in continental Europe.
If the representatives of such railway companies did not develop new concepts of accounting, notably as concerned depreciation, they had, by 1875-1879, elaborated a new theory of accounting (historical cost or dynamic theory).This theory had a profound impact at least on the German theorists of the late 19th century and early 20th centuries such as Simon, Rieger and Schmalenbach.
This new theory was needed to justify a new law favoring shareholders in a hurry for returns on their investments rather than company creditors. It also defeated the ideology of public finance and patrimonial (or static) theories of accounting. This new theory preceded the law which promulgated the new approach and clearly defended the private interests of shareholders as opposed to those of the public in the strict sense. It appears to contradict Watts and Zimmermann's basic hypothesis of the «theory of market excuses». Agency theory seemingly does not to apply either, for the new theory was proposed by managers allied to shareholders, specifically those «hurried share-

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holders", against creditors. This is why a kind of «theory of alliance» appears to be more consistent with these developments. The main reasons for developing the new accounting theory were linked to the issue of dividends. It was necessary to find an accounting approach which would allow the distribution of dividends at the very beginning of an investment cycle. It was also intended to find an accounting approach which would ensure that profits were distributed as evenly as possible throughout the entire investment cycle and among the different shareholders who had financed the investment.

Hence, the second stage of the capitalist accounting development was not connected to measure of performance or information problems (monitoring and bonding) but seems to have been caused by the need to regulate profits and dividends in the interests of managers and shareholders. However, as this change took place within the framework of prudence, it was impossible, at that stage of capitalist accounting, to achieve a perfect smoothing of the rate of accounting profit. The solution to this problem was only to be found at the end of the 20th century with the onset of the third or actuarial stage and the "discovery" of fair value.

INTRODUCTION

Accounting for railway companies is considered to have played a major role in the evolution of accounting thought and practice. This role increased, at least from a theoretical point of view, as leaders of the positivist school referring to Anglo-Saxon accounting literature concerning railways, demonstrate that accounting theories are normative and used as excuses for political action [Watts and Zimmerman, 1979, pp. 273 and 290].

In America and England the history of railway accounting is relatively well known thanks to a wide range of references written over the last seventy five years [Mason ,1933],[Littleton ,1933],[May,1936],[Pollins,1956],[Brief,1966,1967],[Kitchen,1974],[Boockholdt,1978],[Glynn, 1984],[Edwards,1985,1986,1989] and [Bryer,1991]. By contrast, recent literature on the history of accounting for German railway companies is sparse and does not deal with the subject specifically [Oberbrinckmann, 1990], [Schneider, 1987]. There is also some older rather technical literature which is rarely referred to because it is written in German [Reden, 1843], [Passow, 1919], [Barth, 1953] and [Mieles, 1932]. However, this history deserves to be brought to light and made accessible to a larger public in the context of the modern debate about the political and social roles of accounting. It is our intention to fulfil this double task of exhumation and reinterpretation of the history of German railway accounting. Here we focus on the history of private Prussian railway companies which have played such a major role in the development of the German railway system. Our period of study starts in 1838 which coincides with the passing of the first law on accounting for railways and ends in 1884 with the passing of the joint stock law. The latter law was very important, marking a key turning point in the history of German accounting, under the influence of railway managers and their shareholders. Our objective is mainly to respond to traditional questions that have been raised in Anglo- American literature. A first group of questions concerns the role played by railway accounting in the diffusion of new accounting techniques and the reasons why a specific system of accounting has appeared. A second group of questions focuses on theoretical problems: did the development of the Prussian approach to railway accounting influence the developments on any specific accounting theory? If this is the case, does the thesis developed by Watts and Zimmerman according to which "accounting theory satisfies the demand for excuses" apply in the German or Prussian case? In a more general sense does agency theory suit the role played by social actors (managers, creditors and shareholders) in the development of a new accounting philosophy?

Presently, Germany, from an accounting point of view, is characterised as a "code law" country [Nobes, 1992]. This feature is not new and applies to Prussian railway accounting which was strictly regulated with an impressive number of specific or general laws passed in 1838, 1839, 1843, 1861, 1870 and 1884. Each law was the ground for lawyers who defended different positions concerning accounting. The study of this invaluable material will constitute the object of the first part of this article following a brief presentation of the historical background. The second part will be devoted to answering the questions we have previously listed.

THE HISTORICAL BACKGROUND

In Prussia, at the end of the 1820s and the beginning of the 1830s, the very first railway lines were constructed and managed by private companies[1]. This situation lasted up to the end of the 1840s when the State began either to buy (and manage) some companies, such as the Ostbahn and the Saarbrückereisenbahn, or to take over the management of some private companies,

[1] Among the very first ones are lines joining different mines such as the Hardsteiner Review Eberfeld line opened in 1829, and the Deilbach Teilstrecke opened in 1831 [Steitz 1974, pp. 105-109] all founded by an association of private undertakers.

such as the Aachen-Düsseldorfer and the Bergisch-Märkischen railway companies [Mieles, 1932, p. 37]. However, by 1862, the role of the State was not yet dominant as illustrated by the following summary [Steitz 1974, p. 90 quoting Kech's Eisenbahnpolitik]:

fully owned and managed by the State: 1562 km

privately owned but managed by the State: 1355 km

fully owned and managed by private companies: 3050 km

It was only during the nineties that the State, in the context of an economic crisis, took the lead through substantial purchases of private railway companies. This progressive growth of government control culminated in the complete nationalisation of the last remaining private railway companies. In this study, which ends with the joint stock law of 1884, we are only dealing with privately owned railway companies.

Through-out this period, and especially during the thirties and the forties, the main problem with German private rail companies was one of financing. The private companies had hoped that the government would finance their operations with state-bonds[2] but until 1842 this was difficult because of the law of "January17, 1820" (Staats-schuldenedikt) which forced the Prussian authorities to ask for special authorisation from the Parliament [Steitz, 1974, p.170]. So, realistically, up to the forties, private rail companies had depended on private capital. The challenge was not so much a lack of capital as a problem of profits. As Hansemann, a proprietor of textile and insurance companies of Aachen, and one of the founders of the Köln-Mindener (Cologne-Minder) railway company put it, the crucial point was not the capital but the "hope for profits" [Hansemann, 1837, p. 30]. For most potential capitalists, at least, the expectation of profits was for rapid profits if not an immediate return on their investment [Steitz, 1974, pp. 31 and 52].

This demand for immediate and "guaranteed" profits not only clashed with the risk taking approach of "true capitalists" but was also in total conflict with the nature of investments in

[2] If they succeeded in doing that, it could be the occasion for some founders to get very high profits, along with the leverage effect [Eichholtz, 1962, pp. 154].

rail companies which require long periods of construction and also some difficulties at first to have an effective management. As the German history of railways shows, as soon as the hope for rapid profits vanished, many capitalists refused to go on financing the capital already subscribed[3] and sometimes preferred to demand the dissolution of the company. Among the main well known illustrations of this kind of situation, is the case of the Leipzig-Dresdener Eisenbahn, whose Magdeburg's shareholders led a campaign in the newspapers in 1839 to demand a general assembly to decide on the dissolution of the company. And especially the Rhein-Weserbahngesellschaft case, which, in 1844, was driven to dissolution by its frightened shareholders [Steitz, pp. 185 and 196].

The German capitalist founders of the first big railway companies such as Camphausen, the President of the Handelscammer (Chamber of Commerce) of Cologne, and Hansemann (already quoted) were perfectly aware that they could hardly have succeeded in their projects without the help of the State and the administration of big towns such as Cologne and Münster. They proposed, with different modes, an alliance of the private capital with the Junker-state administration. Camphausen, who had led the defunct project of the Rhein-weser company, thought that the private companies could build the tracks but with the help and control (Regalwalt) of the State and that the latter, after a certain time, could take on the administration [Steitz, 1974, pp. 54-55]. Hansemann, the founder of the Cologne-Minden Company, was inclined to think that the private capital could build only the most profitable lines (with the help of State-loans) and leave the burden of the construction of the other lines to the State [Steitz, 1874, p.56].

However different their philosophies were, these captains of industry agreed on the distribution of fixed interest (Zinsen) at a minimum rate of 3, 5% to shareholders not only after the beginning of the operation but also during the period of construction (Bauzinsen). They also admitted the State guarantee in that these interests could be paid independently from the results of the company (in exchange for various modalities which could give the State the possibility of becoming a long term proprietor). These modalities were also sustained by economists, notably List, who published a leading article in favour of the association of the State and the private capital after his come-back from the United States in 1832 [Steitz, 1974, p. 51, quoting Mey-

[3] It was usual during the thirties and the forties to pay only 10% of the shares.

er, 1918]. As Steitz showed, the negotiations with the State were very hard, notably concerning financing through public loans. It is interesting to give an example of their results in the case of the Cologne-Minden Company, one of the biggest projects in the forties. After lengthy bargaining with the State it was agreed in 1843 that the company was to be founded with share capital (Fonds im Aktien Kapital) of 13 000 000 Taler and a participation of the Prussian State amounting to 1/7 of Share capital (it means 1 860 000 Taler). The rest of the share capital had to be found on the free capital market (under the condition of an initial payment of 10%). Independently from their source all shares would receive an annual interest of 4% during the period of construction (Bauzinsen). If there was a need for a supplement of fixed assets this excess would either be financed by additional share capital (with a participation of the state by 1/4) or by loan with the authorization of the board of administration and the ministry of finance.

Beyond financing, the statute of the Cologne-Minden Company also provided for some definition of income: after the opening of the operations the net income (Ertrag) would be calculated by deducting the interests for bonds, the management, administration and reparation (Unterhaltung) costs (Kosten) and a sum for supplying a special Reserve fund[4]. This net income would be distributed first as a 3, 5% guaranteed interest for shares and the rest as dividends. If it exceeded 5% of the capital, the surplus would be shared on the basis of 1/3 for the State and 2/3 for private shareholders. Some special provisions were introduced concerning the role of the State. The surplus paid to the State could be used by the latter to pay guaranteed interests (in case of difficulties of the enterprise) or to amortize (at nominal value) 6/7 of the capital subscribed by privates owners[5].Moreover it was mandatory for the State to proceed to this amortization if the return on the share capital was below 3,5% when the guarantee of the State was required : in that case the State could use the interests received on its share of capital and the interests corresponding to the construction.

Beyond this financial data, it is interesting to mention that certain clauses of the statutes relative to the administration of

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[4] This deduction could not surpass the level of 3% of share capital without the permission of the State.

[5] According to the calculation made by Hansemann, these reimbursements could take 57 years before the State could be the sole owner of the company [Steitz 1974, p. 266].

the company provided for some prerogatives of the State [Steitz, 1974, p. 266]. The decisions about tariffs, the nomination of the head of the board of administration, the main technical directors and the chief accountant (Hauptkassierer) required the authorization of the Ministry of finance. The State had the right to nominate a member of the Directors, who was not obligatorily a shareholder but who retained the right to vote. A royal superintendent (Kommissar) took part in the general assembly with a minimum of 1/7 of the voting power (at the start, with a progressive rise of this proportion to 1/4 and even 1/3 after 35 years). These clauses were written in 1843 after the publication of the law of 1838 governing the railway companies but all the ideas expressed in the Cologne-Minden statute and the law of 1838 (see below) had already been expressed as early as 1832 by List and also by Camphausen during the long negotiation that led to the failure of the Rhein-Weser project from 1837 to 1838 [Steitz, 1974, pp. 182-201].

The main lesson to be taken from these texts for our purpose is that there was an interaction of different types of influences at the head of the private railway companies: an influence of capitalist owner-managers submitted to the pressure of small and "hurried" shareholders and an influence of representatives of the State or of regional administrations. This diversity of influence, of course, was a critical point for the development of accounting as it has already been stressed at the heroic time of the first railways by Von Reden, the director of the Berlin-Station railway [1843, p. 300], and also later by Mieles, whose declarations are worthwhile quoting:

> "usually, the accounting system of German railway companies has been influenced both by the merchant and the public finance way of thinking. At the beginning of the railway period in Germany merchants and public treasury people gathered together. The Treasury accountant[6] (Kameralist) had to recognize the merchant objectives ... and become used to the essence of merchant vision, the desire of profit. On the contrary the merchant had to adapt to the representation of the public finance accountants: this explains why a special form of accounting arose" [Mieles, 1932, p. 29].

[6] Steitz interestingly notes that in the thirties, on the level of the Prussian administration, high officers such as Nagler (director of the Post Office) and Rother (who led the negociation with capitalists such as Camphausen) only knew the public finance (Kameral) accounting [1874, p. 79].

We are now going to analyse what was, for early Prussian railways, this "special form of accounting" and which rules applied to it.

THE EARLY REGULATION OF 1838-1839 AND THE BIRTH OF THE PRUSSIAN RAILWAY ACCOUNTING

The first clear and general representation of the initial Prussian accounting system for railways companies was given by a law published in 1838 and a commentary made in 1839 by the Prussian administration. The Law of railways (Eisenbahngesetz) of "November 3, 1838" was promulgated at a time when there was no strict regulation in Prussia concerning the joint stock companies. The main articles concerning accounting were articles 29, 33, 34 and 38 which we will reproduce hereafter.

> Article 29 : "The company has to determine its receipts (Bahngeld) in order to cover "the costs (Kosten) of maintaining and managing of the railway"...;take account "of a statutory contribution for collecting a reserve fund (Reserve funds) for extraordinary outlays (Ausgaben) concerning the way and the accessories"; "cover other expenses (Lasten) such as the taxes provided at the Article 38"...; "benefit from a net surplus (Reinertrag) including both interest and profit (Gewinn) corresponding to an amount not exceeding 10% of the capital invested (Anlagekapital) and no less than 6% of this capital";
>
> Article 33: "If after deduction of all expenditure (Ausgaben), including the annual amount provided for supplying the reserve fund, the net surplus exceeds 10% of the invested capital the administration is entitled to demand a reduction of the transportation prices".
>
> Article 34: "For the sake of the execution of the articles 29-33 the company has to take into account precise accounting (Rechnung) on every part of its undertaking (Unternehmung) and to follow for that purpose, the indications given by the Ministry of Commerce. The results of this accounting are to be transmitted every year to the administration".
>
> Article 38: "The railway company must pay a tax (Abgabe) which is based on its surplus after deduction of all management and maintaining costs as well as the amount of the contribution to the reserve fund".

Some conclusions can be drawn from these articles. The main one is that contrary to the uses and the laws concerning the merchants, there was no formal obligation to make a patrimonial balance sheet that could include the assets and the liabilities. This point has already been stressed by the German literature of the late 19th [Schüler, 1879, p. 65] and the early 20th centuries [Passow, 1919, p. 241]. The law asked the companies to draw up a cash flow account describing the cash receipts (Bahngeld) and the cash payments (Ausgaben). Of course at that time there was a lack of precision about the terminology (sometimes expenditure was replaced by cost) but the text clearly implied a cash flow accounting system. This was also Schüler's [1879, p. 65] and Passow's [1919, p. 237] opinions. However *it was not a pure cash flow accounting*. Indeed, the law foresaw the possibility (but not the obligation) to deduct a yearly amount from the revenue for "future extraordinary outlays". This amount, in our opinion, was clearly an element of expense and not a call on the net income[7]. The whole system seemed to be devoted to regularly distributing the extraordinary outlays over the periods; *if used,* this device led to a substantial modification of the traditional cash flow accounting system and constituted an important step toward an accrual accounting system.

The other conclusions concern the goal of the system and the concept of profit. It seems that the whole accounting system was devoted to three main tasks: the evaluation of the profitability of the companies (that must not surpass the upper limit of 10% of the invested capital), the calculation of the mass of distributable dividends and the determination of the basis of taxation. According to the law (§ 29) the profit (Gewinn) was calculated *after deduction* of the interest (Zins) paid to the shareholders as a normal and automatic remuneration of their capital, independently from any profit. Keyssner [1875, p. 100] has shown that this stipulation was the legalization of a former practice: he quotes examples of statutes (accepted before the publication of the law) containing this conception of profit such as those of the Berlin-Postdamer Eisenbahngesellschaft (1837) and of the Dusseldorf-Elberfeldergesellschaft (1837). As the famous lawyer noted [1875, p. 128] this conception was contradic-

[7] Passow [1919, pp. 247-248] underlines that the expression "Reserve fund" is an ambiguous if not unfortunate one. Generally, in matter of traditional commercial accounting (at the time of Passow), a reserve is an accumulation of profits; but Passow acknowledges that, as a matter of fact, the Reserve fund may be understood as a renewal fund (Erneuerungsfonds) created by deduction of expenses from revenue [1919, p. 249].

tory to the view of traditional jurists inherited from the Roman tradition notably of Anschütz and Von Völderndorff so as of Puchelt. In our view, it was promoted by managers and economists (Keyssner mentions the influence of the economic science [1875, p. 127]) to reassure shareholders that their share capital was as safe as that of creditors' investments.

In brief, to achieve these objectives, the first Prussian law on railway companies eliminated the traditional balance sheet of the merchants, adopted the model of cash flow accounting as the basis (principle) of determination of profits, but provided a modification of this model to resolve the problem of extraordinary expenditures. These elements are already important to grasp the nature of the initial railway accounting system. However they are not totally clear: what specifically was this cash flow accounting system? Fortunately, the Prussian administration provided the answer to the question soon after the publication of the law.

THE PRUSSIAN INSTRUCTION OF JANUARY 1839

As emphasized by Mieles, [1932, p. 10] the main points of the explanations furnished by the Prussian Minister of Finance deal with distinctions between different cash out-flows. Before presenting the solution of the Minister it must be said, in accordance with Mieles {1932, p. 48], that, normally speaking, in the frame of a pure (true) cameral (cash flow accounting) system, all the expenditures (with exception of the repayment of share capital[8]) must be treated as diminutions of the profit of the year. But the Ministry, in line with legislation or practices already widely adopted abroad, decided that one must distinguish two kinds of expenditures. Firstly, expenditures that do not influence the annual result (erfolgsunwirksame Ausgaben), such as expenditures for the construction and also those for modernising the tracks (as far as conceded by the government and financed by shares).Secondly, expenditures that influence the result of the year, (erfolgswirksame Ausgaben), such as expenditures for the acquisition of inventories, (Betriebsinventorium), for maintaining the tracks, for transportation and for administration.

The reason for this "anomaly" in the frame of a cash flow

[8] As noted by Mieles [1932, p. 48] in cameral accounting cash inflows corresponding to the payment by shareholders of the capital can obviously not be considered as a receipt for the sake of determination of the yearly result; similarly, repayment of share capital is not an element of expenditure.

based system is obvious: it was «impossible» to treat the early and costly expenditures for the construction of the tracks as an element of the yearly result for it would have caused losses and prevented the shareholders from receiving any profit over a long period of time (if the distribution of dividends were based on the accounting figures). Accordingly, the only possible solution to this problem was to agree that expenditure for construction was not an element of result: this was the first but decisive infringement to pure cash flow accounting. This is the reason why Mieles was right to affirm that it was not strict cameral (cash flow) accounting but a «special form» of cameral accounting» [1832, p. 49].

This important concession was able to satisfy the companies. As we are going to see later on, some German accounting laws gave rise to numerous protests. However, this was apparently not the case with the law of 1838: we have not found any trace of protestation against this law in German literature. Even before the promulgation of the law, it seems that the choice of private companies was in favour of a similar type of accounting. Schüler [1879, p. 65] says that in the statutes of the older railway companies, the result was obtained only «on the basis of the relationship between cash receipts and expenditures». Passow [1919, p. 247] quotes the case of the Rhine-Company which, in 1837, had a statute presenting a clause of a reserve fund. Mieles [1932, p. 10] deems that the law of 1838 was a «recognition» of practices that had existed earlier on. After the promulgation of the law, from 1838 to 1843, the companies apparently respected the schedule fixed by the comparison of receipts and expenditures.

According to Passow [1919, p. 247] most statutes provided for a reserve fund but there were differences as to the treatment of this fund. The majority of the companies drew funds after distribution of a minimal dividend[9] but some companies did this by registering expenses before profit calculation[10]. Although there was formally a big difference between the two kinds of formation of the reserve fund, Passow [1919, p. 249] notes that, as a matter of fact, both systems aimed at providing for renewal of the fixed assets.

[9] It is for example the case of the Bonn-Kölner Eisengesellschaft in 1841 [Passow, 1919, p. 247).

[10] Passow [1919, p. 248-249] and Mieles [1932, p. 10] quote the case of the Berlin-Stettiner Gesellschaft (1840); there is also the case of the Köln Minden company in 1848 for a part of its fixed assets [Mieles 1932, p. 10].

THE PROBLEM POSED BY THE LAW OF 1843 AND THE MANOEUVRES OF THE ADMINISTRATION

With the law of "November 9, 1843"on the Joint Stock Companies (Über die Actiengesellschaften) the Prussian Government made provision for a specific[11] regulation of the Joint Stock companies, for the first time. Paragraph 24 of this law stated that the board of directors had to keep such accounting books as to give "a view of the patrimonial situation" (Übersicht der Vermögenslage) and in the first three months of every commercial year had to draw up a balance of the wealth (Vermögen) of the company. Moreover, the paragraph 17 mentioned the principle of the fixity of capital. According to one of the best specialists of commercial law of the 19th century a strict lecture of this law could have rendered impossible for railway companies to produce mere "management balances", which means results based on cash flows, and have required taking account of the values of assets and liabilities [Von Strombeck, 1882, p. 467]. However, fortunately for the state administration and the managers responsible for railways, this law was very imprecise: there was no information concerning the valuation of assets and liabilities and no determination whether the balance sheet would be the basis for the distribution of dividends .This fact is stressed by Schüler [1879, p. 66]. With such a margin of flexibility it was possible for the administration and the managers of railway companies to ignore the law and to go on using the principles stipulated in the law of 1838.

As Passow shows [1919, p. 232] the Prussian administration went on accepting statutes where profits were only based on the comparison of receipts and expenditures: this was notably the case of the statutes of Bergish-Markish (1844) and the Berlin-Hamburger railway Joint Stock companies[12]. A little later on, this resistance of the German railway commercial administration was fostered by the decisions of the tax administration. On the 30 May 1853, a tax law on railways (Eisenbahnsteuergesetz) stipulated in its article 2 that "the net profit (Reinertrag) of the railway firms is considered as the distributable amount ... after deduction of administrative, maintenance and management costs, together with the necessary contribution to the reserve fund and the amounts for the planned retribution and repay-

[11] The ALR law was not a specific law on joint stock companies [Laux, 1998, p. 41].

[12] In the same vein, Mieles [1932, p. 34] who confirms that the law of 1843 has not been applied by the Köln Minden and the Nieder Markisch companies.

ments of the borrowings...». This definition of profit was totally in line with the kind of cash flow accounting advocated by the Minister of Commerce. As Schüler [1879, p. 66] emphasized, this law also disregarded the patrimonial balance sheet.

After this date the Ministry of Commerce continued its "play" with the commercial law of 1843: in 1856 this Ministry published a list of recommendations to be followed so that the statutes of the railway companies could be admitted [Passov, 1919, p. 239]. This time the administration acknowledged that the net profit (Reingewinn) had to be based on the registration of the movements of the balance sheet and not on the calculation of the difference between the receipts and the expenditures [Passow, 1919, p. 239][13]. But this conclusion remained purely formal. Passow [1919, p. 239] shows, on the basis of some published statutes, that the Ministry "went on to accept statutes in contradiction" with the law of 1843.

The evolution of the situation was however worth noting on one single point: the case of "interests" on shares. Under the pressure of the lawyers it was decided that there could no longer be any interest distributed to the shareholders after the construction of the railway but only dividends. However this practice of interest could be admitted during the period of construction on the condition that the company could determine the period of construction and the rate of interest (article § 17 of the law): this concession was obviously obtained for the satisfaction of "hurried shareholders" despite the opposition from strict-minded lawyers. Keyssner [1975, p. 209] notes that this new regulation constrained the railway companies, notably the Cologne-Minden Company, to modify their statutes.

THE LATE EVOLUTION FROM 1843 TO 1861: TOWARDS A KIND OF "DYNAMIC" ACCOUNTING

In 1838, as we have seen, the supremacy of the cash flow accounting had been admitted for the calculation of the profit for railway companies. The registration of a yearly expense for anticipating extraordinary expenses was only a *possibility* opened to the interested companies. This situation changed at the end of the fifties as in 1857 the Ministry of commerce launched an inquiry concerning the question of the "funds" of the railway companies[14]. It was apparently intended to clarify the terminol-

[13] This acknowledgment is confirmed by a circular instruction of March 29, 1859 [Von Strombeck, 1882, p. 481].

[14] These developments are mainly based on Passow [1919, pp. 249-253]. For

ogy, the structure and the goal of these funds and to discuss the possibility of a move towards a more systematic use, with the directors.

The first result of this enquiry was to distinguish two kinds of funds: the reserve funds (Reservefonds) and renewal funds (Erneuerungs fonds). The role of the "Reservefonds" was said to deal with extraordinary and non customary expenditures such as flooding and accidents. The role of renewal funds was restricted to cope with the problem of expenditures for renewals so as *"to permit, as much as possible, the equilibrium (Gleichmässigkeit) in the "loading" (Belastung*) of the proprietors of shares at any time" (text quoted by Passow [1919, p. 252], underlined by the author). This was clearly an instrument to get regular dividends. As Passow says [1919, p. 251] these propositions "seem to satisfy the directions of the railway companies". This could explain that only a year after a circular of "January 27,1958" was issued by the Ministry of Finance, regretting that a renewal fund was not provided for in all statutes and asserting that the reserve funds were not sufficient to take account of the regular wear and tear of the fixed assets. This administration stressed that it was not possible to speak of a distributable profit without an allocation to a renewal fund so as to assure the sustainability (Nachhaltigkeit) of the dividends. Consequently, it logically demanded that the railways directions measured the importance of the yearly allocations for the reserve and the renewal funds in conformity with the views of the inquiry. It also required proving the respect of the disposition of this circular to get the agreement of the Ministry for the determination and the payment of dividends. Unlike the law of 1843, this text had an immediate practical repercussion. According to Passow [1919, p. 252], just after the promulgation of the circular, the new statutes[15] regularly provided for a renewal fund.

To conclude, apparently, in Prussia, at the end of the fifties, the situation for railway companies seemed to be clear: the initial cash flow accounting has been transformed in a kind of accrual accounting devoted to the "regulation" of dividends, which means, according to the Schmalenbach's famous qualification, a kind of "dynamic" accounting [Richard, 1998, p. 576]. But this was without taking account of the "misfits" of the commercial law.

the same view and the same conclusions see also Mieles [1932, p. 11].

[15] Even some "old railway companies" such as the Rhein Eisenbahngesellschaft in 1858, the Bergish in 1859 and the Türingische Eisenbahngesellschaft in 1862 decided to build a renewal fund [Mieles, 1932, p. 12].

THE COMMERCIAL LAWS OF 1861 AND 1870 AND THE UNAVOIDABLE CONFRONTATION BETWEEN COMMERCIAL AND RAILWAY ACCOUNTING

At the beginning of the sixties, lawyers from different states were called up to lay the foundations of the first Commercial Code for the whole of Germany. As a result, the law of "June 24, 1861"[16]forced all merchants (Kaufleute) to follow the rules of the General German Commercial Code. The aim of this Code, in line with the French Commercial Code of 1807, was to protect the interest of creditors by drawing up a balance sheet which enables the comparison of the market value of assets with the bulk of debts, in the hope that the difference between these two amounts could reach a maximum amount, in order to avoid any problem of payment of debt in case of a failure. This type of accounting, which received the name of "static" accounting in continental Europe, [Moxter, 1984; Richard, 2005 b], was mainly expressed in the article 29, 30 and 31 of the Code.

This type of legislation was clearly reinforcing the argumentation of those who, on the basis of the Prussian law of 1843, ascertained that the railway companies had to make a patrimonial balance sheet. However, the defenders of the "special" railway balance sheets could have pleaded the fact that railway companies were not merchant people or companies. But this last hope was also lost with the second step of the commercial legislation: the law of "June11, 1870". The articles 5 and 208 of this law extended the rules concerning merchants and commercial companies to every kind of joint stock (public) company, including railway companies. As stressed by Schüler [1879, p. 66] the presentation of this law (Motiven) clearly expressed that "the making of purely operating (Ertrags) balances and the distribution of purely annual surpluses (blossen Jahresüberschüssen) is inadmissible". Following the article 217 "Only the profit left can be distributed among the shareholders, according to the *annual balance sheet* (which means the patrimonial balance sheet), after an eventual deduction for creating a reserve fund if it is provided for by the statute".

Thus, at that time, the situation was clear: the German railway companies had the choice of either respecting the law or fighting to change it. They chose the second option because it was, as we are going to see, "impossible" to accept the tradi-

[16] This law was applied in 1862 in Prussia [Mieles, 1932, p. 12].

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tional commercial rules[17] [18]

THE FIGHT OF THE RAILROADS AGAINST THE STATIC LAWS OF 1861 AND 1870

This battle lasted about ten years from 1873 to 1883 and mobilized practitioners as well as theoreticians along five main stages corresponding to various declarations and articles.

The first attack was launched, not surprisingly so, by the main contesters, the managers of railway companies. In 1873 a special commission was nominated by the Prussian government to study the problems connected with the railway concessions (Spezial Kommission zur Untersuchung des Eisenbahn-Konzessionwesens). Among the participants was Scheele, the president of the Reichseisenbahn, who declared that "a part of the stipulations of the law of 11 June 1870, especially those concerning the balance sheet, the calculation of dividends and the bankruptcy are not suitable for railway companies". He added that the value of assets" should not be obtained on the basis of their separate components, but according to their value in use (Nutzen), it means the profitability (Ertrag) derived from their global entity" and that this was "important for the payment of dividends, the determination of balance sheet and the problems of insolvency". He also stressed, in order to justify these assertions, that, for railway companies, "it can be considered that the assumption of a *going concern* (vermuthete Fortbestand des Unternehmens) is integrated in the law" and concluded that "the fixed assets... must be considered as *stable items* (stabile Posten) without any impact of future reductions of value" (Declarations taken from appendix of the report by the special Commission published in stenographic report of the debate of the House of deputes, first

[17] According to Mieles [1932 , pp. 31-32] the study of the practice during the period 1861-1884 shows that there is an appearance of the commercial balance sheets (under the name of "general balance sheets") in Prussia : this is notably the case of the Rheinishe EBG(in 1862), the Berlin-Potsdam Magdeburg EBG, the Berlin-Anhalten EBG, and later the Bergisch-Märkish EBG. However, it seems that the railway companies did not totally respect the "play" of the new laws and tried to introduce some "fictitious items" within the new balance-sheets that had nothing to do with the legal balance-sheet. According to Mieles this rise of the problems with commercial balance sheets is the reason which caused Scheffler to intervene (see below).

[18] It should be noted however that the 1862 law, while reiterating the prohibition of interests on shares, went on authorizing the payment of these interests during the period of construction: on this point the lawyers had taken account of the interests of railway companies.

session of the 12th legislature period 1873-74, third volume, pp. 1638 and followings, with some words emphasized by the author). To end with the subject of this special commission, it is worth while noting that to a question concerning the desirability to maintain the existence of interest for shares during the period of construction the consulted expert mandated by the railway companies replied that the consent of interest was "obvious" and that this interest "is part of the fixed assets" [Faucher, 1873, p. 41]. The last part of the answer testified that, for this expert, (as well as the majority of companies) the accumulation in the asset side of interest paid to shareholders during the period of construction was not creating a fictitious asset contrary to the opinion of many lawyers (see below). All these ideas were apparently largely shared by the directors of railway companies[19]

The second attack emanated from the judicial side. Two years after the commission one of the leading commercial lawyers of Germany published a long article and reiterated after Scheele that "the distribution of dividends is not to be connected with patrimonial balances but only with the annual calculation of operating profits (Jahresbetriebsberechnungen)" [Keyssner, 1875, p. 135] . He stressed that anything else is "impossible" especially "the determination of the value of the expensive assets taken one by one independently from each other" [p. 133]. He also added that if a kind of value is to be considered for the balance sheet' "it must be a value derived from the profits (Ertrag) taking the probable duration of the firm" into account [1875, p. 142] and that, as a practical means "the costs form the starting point" [1875, p. 133]. In spite of these basic similarities it seems that Keyssner provided for two new elements in the battle against the old accounting system. First, he emitted the idea that the comparison of assets (at value) with debts and the maintaining of a minimum of capital were not obligatorily the best means to protect the creditors: "the joint stock company could have lost the half of its capital and nevertheless offered an entire security to the creditors, the enterprise is alive if it is capable of getting a revenue" [p. 143]. This was practically a

[19] See also the declarations of Schüler, Director of the "Deutsche Eisenbahnbaugesellschaft", according to whom the appliance of regulations valid for merchants could be "stupid for enterprises whose object is not handling" [Schüler, 1878, p. 66]. Schüler agreed that the valuation of tangible assets and financial participations should basically based on value in use («Macht zu Nutzen») but, insofar as these values are very difficult to obtain, it is better to content with acquisition costs [p. 67]. In any case the recourse to market value could be "a calamity" [p. 67].

new conception for the time according to which the protection of creditors was obtained so long as the current revenues covered the current expenses. Thanks to that position, it "could be possible to distribute dividends to the shareholders even if the whole of the capital is not covered by assets" [Keyssner, p. 143]. Second, he enlarged the scope of the reforms in proposing this scheme for all joint stock companies (and not only railway companies) "the obligatory patrimonial (the one that calculates the liquidation value for the owner of the business) balance sheet could disappear" and be replaced, for the sake of distribution of dividends, by an another type of balance sheet allowing for "an equal division of profits" [p. 144].

The third and neuralgic element of the new course was an article published in 1878 by another lawyer, J. von Strombeck (from Magdeburg) whose ideas also played a significant role in the course of the battle. Von Strombeck, as well as all the preceding actors, admitted that the problem of distribution of dividends for joint stock and especially railway companies was a crucial one and that it was very important to find some means to cope with the problem of "the necessary weak returns in the first year of operation" and to "avoid any influence of fluctuation of prices on the stable assets" [1878, I, p. 17]. He also asserted, as did Keyssner, that, from the part of creditors, "the agreement of credits should not be based on the importance of the capital in its relationship to the wealth (patrimonium) but on the profitability of the fixed assets" and that the traditional legal position was not a convenient one [1878 I, pp. 3 and 23]. These two first elements allowed him to declare, in line with his predecessors, that the legal ("static") balance sheet based on market values was not convenient for shareholders (for the distribution of dividends) and even for creditors, especially in the case of railway companies [1878 I, p. 3].

The originality of Von Strombeck seems to rely on the fact that he proposed a way of *reasoning for a systematic construction* of various types of balance sheets. According to him the content and the valuation of the various assets of companies depended on the "aim" (Gegenstand or Zweck) of this company or of this balance sheet[20] [1878 I, p. 4 and 1878 I, p. 94-95]. Thanks to this basic principle he distinguished three fundamen-

[20] On the beginning of the article (p. 4) the Von Strombeck's classification deals with different types of companies; but on pages 2 and 29 he specifies that inside a same company various types of assets are to be found which can be classified along his principles.

tal categories of fixed assets for joint stock companies [1878, I, p. 4]. The first class comprises assets devoted to the "use in a permanent propriety" [1878 I, p. 4]. Concerning this kind of assets (companies using this type of assets) the rest of the article shows that there is no question of making valuations based on the market values: the assets should appear as stable assets (stabile Grundvermögen) with a valuation at cost. For most of these kinds of assets their usage creates a depreciation (Entwerthung aus Abnützung) which must be, as in the case of railroads, compensated by a restoration (Instandhaltung) owing to a deduction out of revenue so that the assets remained stable [1878 I, pp. 5-6]. The second class comprises assets intended to be sold [1878 I, p. 6] and forms the variable fixed assets. These assets, as illustrated by numerous examples throughout the article, are valued at their exit value (Veraüsserungswerth). The third class is specifically devoted to the assets of insurance companies [1878 I, p. 7]. According to the latter, this kind of company has to treat its assets according to the principles laid for the second class [1878 I, p. 33]. According to these rules, the fixed assets of railway companies and many joint stock companies could be valued at cost, which was satisfactory to avoid price fluctuation and their incidence on the distribution of dividends [1878 II, p. 76].Von Strombeck, differing from other specialists, was aware that this type of balance sheet was contradictory to the law and proposed to change it not only for railway companies but also for all joint stock companies [1878 II, p. 106] He was convinced that these questions and especially the question of the basis for distribution of dividends were of public interest [1878 II, p. 84] at least for railway companies.

The fourth attack against the static law was launched in 1879[21] by Hermann Scheffler, a railway director of the Braunschweig Company. Scheffler was very conscious that the whole affair on the discussion of various balance sheets was fundamentally a *social conflict* opposing the "creditors" who want what he called an "objective value" (objektiver Werth"), which means market value, and the "proprietors" (in our view the shareholders for railway company) who want cost value [1879, p. 34]. He recognized that there was a competition of many possible principles of accounting [1879, p. 20]. He also thought that the construction of a balance sheet depended on the aim the assets are detained for but he added that this aim was connected

[21] According to Mieles [1932, p. 13] Scheffler had presented his thesis as soon as 1875.

to an *analysis of the purposes of the various stakeholders*. According to him the value of an asset that only a proprietor is interested in, (such as a machinery) is the subjective value for this proprietor, which practically speaking, means the cost [1879, p. 23].On the contrary, for objects to be sold, which is of interest to other people than proprietors, the value is the "objective value", which basically means the exit (market) value [1879, p. 24][22]**.**

Interestingly, Scheffler was a strict defender of the theory of cost value for "objective" elements: he made it clear that "no circumstantial event, no variation of price, no variation of profitability and other external time related conditions can change the cost value of assets for use: only the loss due to use must be taken into account and notably with the formation of systematic annual depreciation [1879, pp. 26-27]. Even material inventories such as rail inventories are not to be impaired [1879, p. 40]. More surprisingly, at least for the traditional lawyers but also even for the railway managers of the time, Scheffler was persuaded that every intangible long term investment must be treated as a fixed asset to be depreciated, even foundation costs and education costs [1879, p. 39]: he was a defender of what has been called afterwards, at the time of Schmalenbach, the pure dynamic school!

All these ideas were connected to the problem of profit regulation; Scheffler notably said that the cameral (cash) accounting is "not rational because it can cause a considerable fluctuation of profit" [1879, p. 14]. If he did not explicitly mention the case of the static patrimonial accounting it is obvious that all his work was intended to abolish this type of accounting. It is worthwhile noting that, according to Scheffler, the demolition of this type of accounting was not necessarily connected to the replacement of the law: he thought that the articles 29 and 31 of the 1870 law were sufficiently vague about the concept of value (Werth) so as to admit the cost as a basis of accounting foundation for joint stock companies [1879, p. 20]. In this case a simple evolution of the case law would have been sufficient.

The last part of the story once again concerns von Strombeck whose second article devoted to the question of the making of balance sheet for joint stock companies in 1882. Von Strombeck, like Scheffler, recognized that the problem with the static balances was not one of practical valuation difficulty:

[22] Scheffler (p.24) however distinguishes two kinds of objective value: the first one for long term resale (based on actuarial calculation) and the second one for short term resale (based on market value).

it is always possible if one has decided to apply this theory to find market values, even if necessary, to liquidate value (Abbruchwerth) [1882, p. 491]. No, the problem was a *conflict of interests* between shareholders and creditors implying two kinds of ways to determine a profit [1882, pp. 460, 494 and 495]. Von Strombeck was aware that abandoning the patrimonial balance sheet and its objective value could be dangerous because the new theory of creditor protection by the sole observation of the operating cash flows may, in case of crisis, have as consequence, the disappearance of the companies [1882, pp. 494-495][23]. But a special balance sheet was "required" for dividends [1882, p. 461]. This "dira necessita" (strong necessity) "must lead to the system of stable accounts" [1882, p. 495]. Differing from Scheffler, he maintained that the 1870 law was clearly in favour of market values and not liable to an interpretation in favour of cost, he underlined that there was no other way to change the law: it was even "a matter of public interest" [1882, p. 483)].

THE VICTORY OF SHAREHOLDERS AND MANAGERS AND THE NEW 1884 LAW

This victory was obtained in two steps, the second one being the definitive one. The first break against the 1870's legislation was obtained in 1879 with a case from the ROHG (High Imperial Tribunal) handling the valuation of fixed assets of railway companies. It was declared, in line with the Scheffer's thesis, that the valuation at acquisition cost was not strictly contradictory to the law (ROHG, 1879, Bd 25, p. 307). Even if important, this decision was restricted to the case of railway companies and subjected to criticism according to some leading lawyers who deemed it was a denial of the spirit of the law. Obviously this case was not sufficient to solve the problem. The definitive solution to the problem was given by a change of the law. A new law, the 1884 law (Aktienrechtsnovelle vom "July 18, 1884", RGBI, p. 123), was specifically dedicated to joint stock companies, and added new articles to the corpus for joint stock companies, notably the articles 185 a and 185 b which are very important for the question treated and which deserve to be quoted fully.

The article 185a requires that for the construction of the balance sheet, the four following rules (referring to article 31)

[23] In a very modern way he "answered" to this anxiety by asserting that creditors must make a personal valuation of the risks they take before lending to a business [1879, p. 35]. Scheffler presumably influenced Von Strombeck.

must be applied:

1. Shares, obligations and merchandises which have a stock market or market price may be valued up to this price... but if this price is above the acquisition or the production cost this cost is the maximum limit not to be exceeded.

2. The other assets (elements) composing the wealth ("andere Vermögens Gegenstände") are to be valued to the limit of the acquisition or production cost.

3. Fixed assets and other items which are not devoted to reselling but to durable use... may be valued, with no consideration to an inferior value (geringeren Wert), at the acquisition or production cost, under the condition that a systematic deduction for their use (Abnützung) or a corresponding allocation to a renewal fund (Erneuerungs fonds) will be made.

4. The cost of organisation and administration may not be registered as assets and must appear for their full amount as expenditure (Ausgabe) in the calculation of the annual profit.

According to the official justification of the law itself [Motiven zu Novelle 1884] this new legislation was composed of two very distinct elements. The first element was the recognition of the principle of prudence: from 1884 onwards, for joint stock companies, it was no longer possible to recognize non-realised profits. This was in line with the evolution of patrimonial (static) accounting in continental Europe and justified, as was the case in France about twenty years ago, by scandals related to the distribution of dividends on the basis of potential profits. If the new law had been limited to the recognition of this principle, it could not be said that the shareholders had succeeded in introducing a new philosophy of accounting in their favour. This can be explained by the obligation to take account of potential losses on behalf of diminution of values which would have remained and caused problems.

The very original element of this law was represented by the § 3 of article 185 a that gave the possibility to joint stock companies to avoid the impairment of fixed assets (at their lower market values) and to use a cost valuation assorted with a systematic depreciation. The explanations ("Motiven") of the law are very clear that this new device for fixed assets was dictated by a question of dividends: "if the company had been obliged to take account of market values even for this kind of assets, whose selling price are subject to considerable fluctuation of prices due to the relationship of supply and demand, without their value in use (Nutzungswert) could be changed**,** it would have resulted a full untrue distribution of profits**"** [Motiven, p. 301]. The "Motiven" were also very clear that this part of the legislation was an exception to the general "static" rules which remained in place: "the project of law, in relationship with the paragraph 31 of the Commercial Code, takes as a basic principle, that all patrimonial assets are to be valued at their value (it means market value) but no higher than their acquisition or production cost" [Motiven, p. 303]. But this exception was the only exception: the generalisation of a system of distribution of costs as proposed by Sheffler for intangible long term expenses was not accepted as it was notably clearly expressed for organisation and administration costs (see supra article 185a-4).

THE NATURE OF THE CHANGE INFERRED BY THE PRUSSIAN RAILROAD ACCOUNTING

In our opinion the events described above clearly show that the "time of railways" was the beginning of the death for cash flows ("cameral") and patrimonial (static) accounting styles, at least in Germany. We have seen that under the influence of public accountants, at the very beginning of this period, the thirties, a kind of cameral accounting had generally been applied to railway companies. It is important to stress that this cameral accounting was not a pure one for it was decided to treat the initial expenditures (for constructions and purchase of rolling stock) not as elements of results (as should normally have been the case) but as an investment: it was, to use Mieles's expression, a "modified" cameral accounting. This already mongrel accounting was again changed in the fifties with the more and more massive introduction of a kind of depreciation accounting instead of the registration of expenditures at the time of renewals. Towards the end of the period studied it can be said that, as far as private[24] railway companies are considered, the cameral accounting was over or very nearly so: this was the first victim of the railway accounting battle.

In the seventies, railway directors and some lawyers connected to them, led another successful fight against the applica-

[24] This assertion is untrue for state-owned railway companies up to 1927.

tion of static (market oriented) accounting, which was at the time, the dominant kind of accounting. In 1884, as a result of this last fight, static accounting was no longer obligatorily applied for fixed tangible assets for all joint stock companies. It was also the beginning of a (long) agony for static accounting and the first clear introduction of very important elements of historical cost accounting. Concerning this last point (the breakthrough of a kind of dynamic accounting in 1884) there is not much debate among historians. For example, Walb [1933, p.5] deems that there is a kind of return to the solutions of the ALR, after 90 years. These solutions were largely marked by a refusal of market value [Richard, 2005c], and Barth [1953, p. 117] and constitute a "decisive breach" (entscheidende Bresche) in the common market value (gemeinenWert) for balance sheet valuation. However, Schneider, [1995, p.151], while commenting on the 1884's law, is more struck by the appearance of the principle of prudence (lower of cost or market rule) than the development of any kind of dynamic accounting.

THE REASON FOR THE CHANGE

There is considerable debate concerning the reason for change, in comparison to the points previously developed. First we are going to highlight what appears to be the opinion of German historians before giving our own interpretation.

Barth insists upon a technical point of view: the patrimonial (static) theory would have failed and needed to be replaced because in "many cases, especially for fixed assets it is almost impossible to find a reliable market value" [1950, p. 53 and also similarly 1953, pp. 116 and 147]. He also adds a second argument: even if these technical difficulties could be solved, it would result in «a totally arbitrary income which has nothing to do with the real profits (Erträge) of the enterprise" [1953, p. 116] because rising prices could eventually trigger the distribution of unrealised profits [1950, p. 52]. It seems to us that this second motive is not important for our case for the static lawyers, beginning with first the French and [25] then the German lawyers, had been able to respond to this type of criticism (thanks to the lower of cost of market rule) with no change to their basic philosophy of accounting style for the protection of creditors. So, to conclude, the technical problem remains Barth's main argument.

[25] According to Dupin notably as quoted by Barth himself [1950, p. 52]

The Schneider's thesis is another one which means competence problem**.** Schneider [1995, pp. 132-133] stresses that throughout the twentieth century "the discussion of financial accounting was dominated by lawyers" who were unaware of merchant book keeping and that, as an exception, was unfamiliar with double book keeping which led a commercial lawyer (meaning Keyssner who led this fight against static accounting) to calculate distributable profit separately from the balance sheet".

In our opinion all these arguments cannot explain the real reasons of the change. As far as the technical argument is concerned, it is interesting to note that von Strombeck himself, a strong partisan of the "system of stable accounts", however, acknowledged that "the reason for its adoption was not so much the difficulty to find a true valuation of fixed assets as rather the possibility to use, in particular for the distribution of dividends, a mass of results only depending on the utilities produced by stable wealth (patrimonium)" [1882, p. 464]. He added that "in the case of a patrimonial balance sheet, the biggest difficulty and the uncertainty to find an objective value must not deter from proceeding with a valuation and that, in case of doubt... at worst, one can use the liquidation value" [1882, p. 491].

As for the argument of competence, one can wonder why lawyers such as Keyssner and Strombeck could inevitably discover the virtue of merchants' bookkeeping while their colleagues, authors of the 1870's legislation, were unable to take this step. Our explanation is that, beyond a question of competence, there was a question of social environment: these men "discovered stable accounts" (to use the von Strombeck's expression) because they were the spokespeople for railway managers and shareholders and expressed their needs.

But what were these needs? What was the reason for this "impossibility" to use the patrimonial type of accounting as evoked by Keyssner [1875, p. 133]? What was this "dura necessita" mentioned by von Strombeck [1882, p. 482] forcing to adopt the system of stable accounts? Our answer is that "stable accounts" (a marvellously eloquent expression) were necessary to give stable dividends to shareholders, a sine qua condition to collect funds and to develop railway companies and big joint stock companies. The importance of the stable dividends question is not only acknowledged by German historians of railway economics. At that time this question also constitutes the very framework of reasoning for all the defenders of dynamic accounting versus static accounting. Whether it is the case of

Keyssner [1875, p. 144], of von Strombeck [1878 II, p.76] or of Scheffler [1879, p. 14] their common fear was price fluctuation and its influence on dividend distribution. Even the documents explaining the motives for the 1884 law, have, as we have seen, evoked the problem of dividend stability. Our conclusion is that the birth of a specific type of accounting for railway companies and the promulgation of a specific law for joint stock companies was due to the need for greater dividend stability. This could not have been reached with the previous types of accounting.

This stability was not only required for the sake of one particular shareholder. It was also required for distributing investment products equally among the different shareholders who had been participating in this investment all through the period. To summarize, the birth of historical cost dynamic accounting in German legislation was a product of shareholders craving for stable and equally distributed dividends over time.

THE EXISTENCE OF A THEORY

The previous developments have shown that during the period 1870-1884 all the main actors of the struggle against the patrimonial accounting defended a kind of historical cost (dynamic) accounting. One interesting question is to know if they have succeeded in the creation of a (new) theory of accounting. This question had already been raised by German authors notably by Walb, Barth and Schneider who disagree over this. We are relating their position before expressing our own opinion.

As early as 1983, Walb, in his history of the balance sheet dogma, deems that Scheffler "has made an important step in matter of accounting theory" [1933, p. 11]. He thinks that Scheffler had "conscious dynamic objectives" [1933, p. 15] and had finally "opened the road for the whole of the future evolution" [1933, p. 17]. Also Mieles [1932, p. 13] insists upon the influence of Scheffler on the thoughts of the great theorist, Simon. On the contrary, according to Barth, it was only after the publication of the 1884 law on joint stock companies that the theory of balance sheet tried to find a justification for the use of cost valuation in matter of balance sheet dressing" [1953 I, p. 117]. Barth thinks that the movement of ideas towards the historical cost accounting system before 1884 *was not conscious*, only inspired by practical point of views [1953 I, pp. 156-157].

If we concentrate our study on Scheffler, who benefited from the whole intellectual contribution of Keyssner and von Strombeck, we may observe that, in order to justify his position in favour of an historical cost accounting, Scheffler uses the concept of goal (Zweck) to distinguish different types of assets (assets for permanent use, assets for sale). He also deducts a type of valuation from this classification (valuation at cost for assets for use, valuation at market price for assets for sale) and infers from the two previous points an adequate treatment for the main types of assets. Is there any big difference, for these main elements with the ideas expressed after the First World War by theoreticians of the dynamic balance sheet such as Rieger and Schmalenbach? Not in our opinion. It would seem that Scheffler was an even more consequent theoretician than Schmalenbach in so much as he deducted the treatment as assets of intangibles expenditures such as organisational costs from his theory. As a matter of fact Scheffler, as well as von Strombeck, were, contrary to Barth's view, perfectly aware of the fact that they lived a battle of ideas about conflicting modes of calculation of profits (see notably von Strombeck [1882, p. 460]). They were even conscious that they defended the interests of shareholders against those of creditors. Their articles not only suggest a list of practical wishes: they also constructed along a hypothetical-deductive reasoning, and offered the framework of a social theory for historical cost accounting.

For the first time in Germany, if not in the world, the framework of a social theory for historical cost accounting was clearly expressed.

THE CONTRIBUTION OF PRUSSIAN RAILWAY ACCOUNTING TO THE DEVELOPMENT OF FINANCIAL LEGAL ACCOUNTING

A classical, if not dominating thesis, is that railroad accounting has played a major role in the development of accounting concepts, especially concerning depreciation, and more generally in the development of modern accounting theory. The traditional references are those of Holmes [1975] and Boockholdt [1977]. But a German author had expressed the same thesis as early as 1933: "the theory of balance sheet was driven to more clarity by the enterprises with large fixed assets especially railways. This evolution made of the profit and loss statement the main statement" [Walb, 1933, p. 7 and 17]. As Walb's assertions were never translated into English, his views were condemned to oblivion. According to Holmes [1975, p. 18] "depreciation was a knotty problem for these early railroad accountants. They argued over it... but in the end it was from the very ashes of their disagreements that a modern concept of depreciation arose, Phoenix like, fifty years later". Boockholdt while sustaining the same idea [1977, p. 14] enlarged it: "many of the basic concepts of accounting theory such as disclosure, matching measurement of cash flow, had origins in railroad accounting" [1977, p. 9]. However this thesis has been contested by Lemarchand after his study of the historical development of railroad accounting in France. According to Lemarchand, in a general way, if it is likely that, in matter of management, the railway companies have had an influence on the working of enterprises belonging to other sectors; it does not seem so obvious that their accounting behaviour could truly have had an influence likewise. [Lemarchand, 1993, p. 525].

If we take the example of systematic depreciation (with distribution of cost over the period of use of the fixed assets) it could hardly be maintained that this concept has been created by railway accountants both in France and in Germany. In France Lemarchand has shown that, as far as practice is concerned, some examples of such a systematic depreciation can already be found in the 18th century (especially in the second part) : depreciation of horses at the "Forge d'Oberbruck et Manufacture de fer blanc de Wegsheid" in 1739 [Lemarchand, 1993, p. 97], depreciation of furniture (by 5%) by the "Company Rey and Magneval" in 1751 [Lemarchand, 1993, p. 69], depreciation of tools, buildings and horses by the "Manufacture de toiles peintes de Rey" between 1763 and 1792 [Lemarchand 1993, pp. 73, 74,98], depreciation of tools by 5%) by the "Manufacture de quincaillerie de la Charité sur Loire" in 1767 [Lemarchand 1993, p. 227], depreciation of machinery (by 4%) by the "Manufacture du Logelbach" in 1775 [Lemarchand, 1993, p. 227], depreciation of furniture and tools (by 1/24%) by the "Manufacture royale de velours de coton de Sens" in 1778 [Lemarchand, 1993, p. 1].

The original German feature in this respect can be found as early as 1794: it is also possible to find a legislation (Allgemeine Preussische Landrecht - ALR - second part § 545) in Prussia concerning the calculation of profit of commercial companies with a clause enouncing that (in case of no special stipulation by statute) the corporate fixed assets are to be systematically depreciated [Barth 1953; Lion 1928; Schneider 1987; p. 443; Schneider 1995, p. 129][26]. Of course this kind of (optimally) dynamic ori-

[26] See also Richard [2005 c] for a comparison of German and French situations in the context of evolution of the fair value concept.

ented legislation was soon rebutted by the static ideas of the Napoleonic Code of Commerce [Richard 2005 b and c], which was translated into German in 1808 by Daniels [Bösselmann, 1939, annexe 4]. The French code was notably applied in the Rhine provinces even after the collapse of Napoleon[27] [Steitz, 1974, p. 26] and inspired the endeavours of a commercial codification of States such as Württemberg in the thirties [Barth, 1953, p. 67]. This may explain why, in Prussia, the law on joint stock companies published in 1843 no longer mentioned the possibility of a systematic depreciation of fixed assets and presumably diverted to a static viewpoint. Nevertheless it seems almost unbelievable that, at the beginning of the 19th century, the Prussian merchant and lawyer elite was unaware of the ALR and of its mention of a dynamic style of depreciation. Furthermore, as Schneider demonstrates [1987, p. 451], it was "not usual to see systematic depreciation based on percentage of fixed assets before the second part of the 18th century". A number of books can also be found (rarely during the 18th century but more frequently at the beginning of the 19th century) that describe the principle of such a depreciation, the first author being Magelsen [1772, p.76]. The conclusion is that railway accountants and managers have, in no way, contributed to the creation of the concept of dynamic depreciation. But, on the contrary, they have played a very big role in the dissemination, the theoretical justification and the legalization of this concept. They contributed to the dissemination because the majority of railway companies, that represented the biggest companies at that time, applied this type of depreciation at the beginning of the sixties. They play an important role for the theoretical justification thanks to the publications of railway managers or lawyers closely related to them. They succeeded in legalizing through the articles of the 1884 law as a result of the pressure of railway lobbyists. To summarize, there has been dynamic depreciation and more largely dynamic theory, a dominant approach of accounting.

THE VALIDITY OF THE "MARKET FOR EXCUSES" HYPOTHESIS

In their article about the demand and supply of accounting theories Watts and Zimmermann [1979] outline their hypoth-

[27] The result of this situation was that until 1861 Prussia had two law territories: the West part under French law commercial legislation and the East part under ALR, which was not a specific commercial legislation [Steitz 1974, p. 26].

esis of a market for excuses according to which, in a regulated economy, they "expect to observe changes in accounting theory when a new law is passed which impinges on accounting practice" so that "accounting theory has changed *after* the introduction of government regulation" [1979, p. 289 emphasis added]. It is clear that they base their reasoning on the case of US railroad legislation : it is their hypothesis that regulation of profits (primarily of the railroads) "created a demand for theories rationalizing depreciation as an expense" and that "without regulation there was no necessity for depreciation to be a charge systematically deducted each year in determining net income. However, because rate regulation was justified in terms of restricting the economic profits of monopolists (or eliminating ruinous competition) regulation created a demand for justifications arguing for depreciation to be treated as an annual charge to profits" [1979, p. 293]. They concluded that accounting theories are generally "normative" because "they are used as excuses for political action (i.e. the political process creates a demand for theories which prescribe rather than describe the world)." [1979, p. 273].

In the case of the German legislation for railway companies we do not find any evidence of a market for excuses hypothesis .In contrast to Watts and Zimmermann's hypothesis it seems that the change in accounting theory appeared *before* rather than after the law which this theory intended to defend and that this theory was *describing* an already existing practice. The sequence of the German case is the following: at the beginning Prussian railway companies produced a special type of balance sheet and had a concept of profit oriented to their needs. This practice had been largely incorporated within the law of 1838, the fundamental law concerning rail companies. This was improved through various administrative regulations from 1838 to 1862, aiming notably at a systematic form of depreciation. Throughout this period, to the best of our knowledge, there has been no article or book presenting a theory in defence of this legislation or control. The reason for this absence of theory seems obvious: the legislation was basically in line with the practices or the desired practices of the managers and shareholders of railway companies. Thus there was no reason to justify anything.

The scene completely changed in 1862 and 1870 when a new law developed by lawyers working for the interests of creditors (rather than shareholders) obliged the rail companies to produce balance-sheets in total contradiction with their vital interests. As a reaction *against* these laws and in order *to get a new* *law* more favourable to their interests, the railways managers and a few astute lawyers sharing the interests of shareholders against creditors wrote a significant list of articles in the seventies which, in our view, should be considered as founding a new theory of what we call "dynamic accounting" or "historical cost accounting". This theoretical weapon in favour of a new law succeeded in 1884 with a law which offered all joint stock companies (and not only railway companies) the possibility of using the dynamic theory for tangible fixed assets for the first time in Germany.

As a conclusion, the German case shows that the theory came *before* the introduction of a new law and was used to prepare it. Furthermore, this theory largely describes a practice in line with shareholders' interests and was *frankly advocating* the basic interests of these shareholders. There was no attempt to disguise the needs of short term and regular dividends for hurry and worry shareholders under the umbrella of "excuses". Based on this case, our hypothesis is that accounting theories may be considered as a weapon to demolish existing practices or regulations rather than an excuse or justification for existing legislation or practice.

THE VALIDITY OF THE AGENCY THEORY

Agency theory, as represented by the fundamental article by Jensen and Meckling on the theory of the firm [1976], expresses three main ideas. Firstly, in the firm, the basic conflict opposes on the one hand the managers and on the other hand the "outside" equity owners and the creditors. The possibility of a conflict between the outside equity owners and the creditors is only marginally indicated in two backside notes [1976, pp. 337 and 339]. In fact the opposite applies, bondholders and outside equity owners are treated together as potential victims of the managers (1976, p. 338). Secondly, the basic conflict can be solved by the signature of contracts concerning the monitoring activities, the bonding activities and the emission of shares: these contracts can be fair because creditors and outside shareholders have the possibility of knowing the manoeuvres of managers in advance. Even the suppression of unlimited liability is accepted by the creditors by means of a fair contract [1975, p. 331]. Thirdly, as implied by these two former points, accounting can be considered as an *information device* solicited in the course of the issuance of fair contracts between managers and outside claimants.

The history of the Prussian railway accounting illustrates that these ideas do not correspond to reality[28]. The main conflict in Germany opposed the creditors on the one hand and the outside shareholders and the managers on the other hand. One could speak of a "theory" of alliance between managers and shareholders and not of a "theory" of agency. The losers of the battle, the creditors, were not in a position to sign any compensatory contract. They had to accept the (partial) disappearance of static accounting because they were weak and they did not have the power to resist the alliance of shareholders and managers.

Accounting, in the course of this battle, was not considered as a source of information on managers' actions but as a means of improving their situation as well as the shareholders' situation in the matter of distribution of dividends. The new dynamic theory was not devoted to calculating the performance but to regulating the distributable profit. In short, the issue was not a question of "fair" contracts or "fair" information but of the exercise of harsh power for the sake of the development of a new kind of capitalism.

CONCLUDING REMARKS: THE ROLE OF THE PRUSSIAN RAILWAY ACCOUNTING IN THE DEVELOPMENT OF THE CAPITALIST ACCOUNTING SYSTEM

On the basis of the French experience, it has been suggested that after the beginning of the industrial revolution (at the end of 18th and the beginning of the 19th centuries) the capitalist models of regulated financial accounting went through three main stages of development : static, dynamic and actuarial ones [Richard, 2005 b and c]. The history of accounting of private rail companies in Germany shows that in this country the rail companies played a major role in the spread of historical cost accounting principles. In addition, these companies and big other joint stock ones, largely contributed to the birth of the "dynamic" second stage, at least in continental Europe. If the representatives of these rail companies had not invented new concepts of accounting, in particular concerning depreciation, they did, as early as 1875-1879; elaborate a new theory of accounting (the dynamic theory). This new theory had a profound impact, at least on German theorists such as Simon, Rieger and

[28] For another example of this disconnection between agency theory and the historical reality see Ding and alii [2008].

Schmalenbach of the late 19th century and the first part of the 20th century. It was needed to justify the publication of a new law favourable to the interests of impatient shareholders rather than those of creditors and to defeat the ideology of public finance and patrimonial (static) theories. As this theory appeared before (*rather than after*) the law which promulgated the new approach and was clearly advocating the defence of the private interest of shareholders (not those of the public in the strict sense), it would seem possible to assert that the Watts and Zimmermann's basic hypothesis of the "theory of market excuses" does not fit with these historical developments.

According to these developments, the main reasons for developing the new accounting theory were connected with problems of *dividends*. Firstly it was imposed by the necessity to find accounting procedures which would allow the distribution of dividends from the very beginning of the investment cycle even in the absence of revenue. Secondly it was fostered by the desire to find an accounting model which would enable the distribution of profits generated by an investment evenly throughout the investment cycle and amongst the different shareholders taking part in the financing of this investment.

Hence, the second stage of development of capitalist accounting may have been caused by the question of distribution of profits and dividends and *not of information*. However, as this attempt took place within the framework of the principle of prudence, it was impossible, at that stage of accounting capitalism, to achieve a perfect device for the regulation (smoothing) and the rise of the rate of accounting profit: the beginning of the solution was only to be found at the end of the 20th century with the third actuarial stage and the "discovery" of fair value accounting [Richard, 2004, 2005 b and 2005d].

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