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Research on the Evolution of Accounting
Thought and Accounting Practice

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2010 Manuscript Awards

We are pleased to announce the following winners of the annual AHJ Manuscript Competition for Volume 37 (2010) 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: Warwick Funnell: "On His Majesty's Secret Service: Accounting for the Secret Service in a Time of National Peril 1782-1806"

RUNNERS-UP: Nicholas Praquin: "The Credit Lyonnaise in France (c. 1871-1918): Using Cash Flow Analysis to Assess Risk in Banking"

Louis Stewart: "A Contingency Theory Perspective on Management Control System Design among U.S. Ante-Bellum Slave Plantations"

Congratulations to the authors for these fine pieces of work.

It should be noted that every article in Volume 37 received at least one vote on the ballots submitted.

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Jesse F. Dillard
PORTLAND STATE UNIVERSITY
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VEBLEN'S PLACEBO: ANOTHER HISTORICAL PERSPECTIVE ON ADMINISTRATIVE EVIL

Abstract: Thorstein Veblen was a turn of the 20th century American economist concerned with the implications of financial capitalists directing the means of production. Veblen proposed that the rationality of "material science" as practiced by the "production engineers" is fundamentally different from the rationality of market capitalism. If this claim is valid, our previous contentions regarding accounting, as a facilitating technology, for administrative evil warrant reconsideration. Veblen's position provides a historical perspective on one dimension of administrative evil that is generally unquestionably accepted, especially within accounting. That is, technology, such as accounting and the related information systems, is amoral, and it is only through ideologically instigated applications that any moral value accrues. We discuss administrative evil and the role of instrumental rationality generally, and accounting specifically, in creating it. Veblen's characterization of financial capitalism and production engineers and his arguments for the primacy of economic efficiency versus "pecuniary gain" provide a basis for evaluating the legitimating action. We consider how Veblen's work relates to notions of instrumental rationality and then undertake a critical assessment of the ideas. Some of Veblen's ideas, while utopian, might be seen as an elixir for the detrimental influences of financial capital; however, at best, they provide a placebo for the ills of administrative evil and, as such, do not provide an amoral basis for legitimating the associated accounting systems.

INTRODUCTION

Ideology and technology form a nexus in fostering and

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perpetuating conditions that deprive innocent people of their humanity. In previous work [Dillard and Ruchala, 2005], we argue that the ideology of capitalism and the instrumental rationality of accounting, as a facilitating technology, advance this administrative evil within work organizations. Thorstein Veblen, an American economist writing in the early 20th century, recognized the possible dangers associated with financial capitalists' control of the means of production with their sole perspective being reduced to financial returns.[1] As the solution, Veblen proposed that the conduct of "business" be removed from financial capital and placed in the hands of the "production engineers." Such a move shifts control from a group whose legitimacy is based on the rationality of capitalist markets to one predicated on the rationality of "material science." Similar arguments have been made by Johnson and Kaplan [1987] and others with regard to "management accounting." That is, the relevance of the technology of cost and management accounting (information for running the productive core of the work organization) was lost when it was colonized by the rationality and information demands of financial capital (financial reporting). If the rationality of Veblen's "material science" is fundamentally different from the rationality of market capitalism, then our previous contentions regarding accounting and administrative evil warrant reconsideration.

By gaining an historical perspective on instrumental rationality, we extend the previous analysis exploring the nexus between ideology, technology, and accounting and how instrumental rationality has been used to legitimize the actions within and through large work organizations. Veblen's work represents an early socio-economic analysis of large corporate enterprises [Raines and Leathers, 2001], providing a critique of capitalist ideology and the role of technology and technicians and being severely critical of the former while adamantly embracing the latter. He proposes the shift in control as a response to the dehumanizing and inefficient march of financial capital. If Veblen is correct, then it may be possible to ameliorate the effects of administrative evil by "returning" to the spirit of the halcyon days before management accounting became colonized by financial accounting. That is, returning to the conceptualization of management accounting systems based on relevant production-related data needed by production managers in managing pro-

[1] As discussed more fully later, while we also rely on many of Veblen's writings, our primary source is Veblen [1921].

duction and output, not the reductionist demands of financial capital. Can proposals such as activity-based accounting [Cooper and Kaplan, 1988], activity-based management [Johnson, 1994], or the balanced score card [Kaplan and Norton, 1996] assist in enhancing human dignity through work and production as Veblen implied? Can these ways of framing, understanding, and acting provide a means for ameliorating administrative evil?

Veblen's work provides an historical perspective on the generally accepted legitimacy of technical expertise as justification for corporate action. That is, technology as applied by professionals/experts is amoral and only through ideologically instigated applications do any moral implications arise. Because of their superior technical knowledge of production and uncorrupted nature, Veblen proposes that society would be better served if technicians replaced absentee owners/capitalists as the primary guardians and managers of corporate resources. Engaging Veblen's ideas helps articulate more clearly the different manifestations of expertise, especially within work organizations and helps recognize technicians as implementers, purveyors, and repositories of technology. As such, these "experts" represent the human manifestation of technology, taking on its cloak of amorality.

Veblen differentiates between "physical" and "financial" expertise and lays out a plan whereby the former is to replace the latter. This proposal purports to be a panacea for the evils of capitalism and absentee ownership that follow from the self-serving programs of the "captains of industry." At one level, Veblen's recommendations/remedies seem imminently "logical" in that the capricious, socially grounded, and legitimized controlling/organizing systems of self-motivated financiers are replaced with those grounded in the "laws of nature" and implemented by those who understand, respect, and are held accountable by these natural laws.

Writing in the same era as the development of management/cost accounting,[2] Veblen's arguments are useful in understanding the underlying logic of these systems of management and cost accounting. We believe that Veblen's position provides a perspective on one dimension of administrative evil that is generally accepted, especially within accounting. That is, technology, particularly as associated with material science, is amoral,

[2] See Chandler [1977], Johnson and Kaplan [1987], Miller and O'Leary [1987, 1994, 1998], Hopper and Armstrong [1991], Arnold [1998], Fleischman [2000], and Hoskin and Macve [2000].

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and it is only through ideologically instigated applications that any value accrues. While this, in fact, does displace one instigator of administrative evil, we argue that the primary culprit for divorcing moral context from collective action is still very much activated, and maybe made even more insidious, because it is now masked by the legitimating veil of physical laws of nature and their perceived amoral status. These "laws of nature" are no less a social construction than those Veblen proposes they replace. "In reality, technology is nothing but a form of applied economics, which is determined by a certain problem, since in the last instance each technician asks, What does it cost?" [Weber quoted in Swedberg, 1998, p. 148]. Both, we argue, are legitimated and perpetuated by appeals to and the application of instrumental rationality.

The technological imperative is one of the primary structural foundations upon which administrative evils is predicated and legitimized. We view Veblen's work as an early example of a somewhat misdirected/misleading panacea for overcoming the administrative evils associated with administrative control. Thus, Veblen's work is useful in dimensionalizing the forms of legitimating structures within administrative evil. We argue that "pecuniary" and "industrial" activities do not represent opposing constructs or dualisms[3] but, in fact, exist as a duality in which both represent different dimensions of a common construct that is grounded in instrumental rationality. Production engineering, and the related systems of management and cost accounting, is a socially constructed technology predicated and legitimized by its logical grounding in instrumental rationality. The underlying ideology of the technology also constitutes the underlying rationale for capitalism. Such "remedies" will only shift the genesis of the forces, depriving innocent human beings of their humanity.

The remainder of the discussion is organized as follows. Section two describes administrative evil and the role of instrumental rationality in creating it. The third section presents Veblen's position on financial capitalism and production engineers and the presumed primacy of economic efficiency versus "pecuniary gain" as the basis for legitimate action. In this section also, we consider Veblen's work as it relates to current notions of instrumental rationality and then undertake a critical reassessment of his technocracy. We end our investigation of Veblen and administrative evil with discussion and conclusions.

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[3] Dualisms are constructs that cannot be synthesized or reduced to the other.

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ADMINISTRATIVE EVIL, INSTRUMENTAL RATIONALITY, AND ORGANIZATIONAL ACTION

Several recent papers in the accounting literature[4] explore the idea of "administrative evil" and the role that instrumental rationality plays in initiating and perpetuating such evil. Adams and Balfour [1998] coined the term "administrative evil" to describe the use of technology, professions, and bureaucratic structures in ways that divorce collective actions from their moral context, removing any sense of personal accountability. Dillard and Ruchala [2005] conclude that contemporary accounting is constituted by "rational" practices of modernity from which administrative evil emerges.

As in the prior work, administrative evil describes actions that ordinary people take while carrying out their normal organizational responsibilities that result in depriving innocent people of their humanity. These acts/circumstances include depriving an individual of life, dignity, health, justice, security, opportunity, or freedom.[5] We consider the deprivations to be immoral acts. Examples of administrative evil can be direct, such as the loss of life experienced by Holocaust victims, or indirect, such as organizationally sanctioned actions as knowingly hiding health risks of medical pharmaceuticals, the loss of employees' pensions as the result of corporate malfeasance, or the loss of property because of sanctioned aggressive lending tactics.[6]

Administrative evil is an outgrowth of social roles and institutional structures motivated by the application of instrumental rationality. Instrumental rationality is an integral part of accounting and represents one primary component of its claim to significance. As currently practiced, accounting represents an ideologically saturated calculative technology; a group of experts to implement and sustain the technology and its application; and, as such, provides a sustaining medium for the perpetuating mechanisms of capitalism.

Dillard and Ruchala [2005, p. 617] recognize the interplay between the individual or collective and ideology and technology in separating collective actions from moral content:

> The application of the technology in the cause of maxi-

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[4] Williams [2002], Dillard [2003], Dillard and Ruchala [2005], Dillard, *et al.* [2005]

[5] See United Nations [1948].

[6] Adams and Balfour [1998] provide extensive examples, including the Challenger space shuttle and the tobacco industry's actions in concealing the known hazards of cigarette smoking.

mizing shareholder wealth enhances the dominance of the prevailing capitalist ideology. The economically grounded and unequally privileging aims are developed, clarified, and expanded through instrumentally rationnal problem solving and physical and administrative technology. Technology can enhance and accelerate the capitalists' demands. Coupling the capitalists' demands with advanced information technology implemented through bureaucratic hierarchies facilitates their immediate, disciplined, and efficient implementation.

Instrumental rationality implies a neutral orientation in which decision processes and actions are focused on achieving the specified end without the need to appraise the legitimacy of the end [Jary and Jary, 1991]. For example, an accountant is tasked with representing the financial position of a firm using generally accepted accounting principles. Generally, the accountant does not question the legitimacy of creating such statements or their use.

Adams and Balfour [1998, p. 25] note that: "Technical rationality, professionalism, and bureaucracy all redefine ethics out of the picture in many instances." They go on to describe how "moral inversion" and administrative evil can evolve such that choices depriving innocent people of their humanity can be legitimized as the "good or right thing to do" by material or external authority structures. Building on Adams and Balfour's work, Dillard and Ruchala [2005] argue that instrumental rationality fosters and perpetuates administrative evil through the roles played by ideology in shaping accounting systems, expertise, and technological processes.

Following Dillard and Ruchala [2005], instrumental rationnality represents the enabling logic of modernity; however, its application restricts the conceptualization of legitimate alternative action sets. The logic of instrumental rationality is implemented through technicians,[7] machines, and organizing hierarchies. Within and facilitated by these manifestations, one can be an accomplished professional/worker and still enable extreme acts of violence.[8] The technician can faithfully and correctly apply their skills to the task at hand while abdicating any personal

[7] Following Veblen, we use the term technician in its broadest sense of possessing expertise.

[8] Violence, as used in this paper, refers to the harm resulting from administrative evil. Workplace violence differs from the harm resulting from administrative evil in that the individual perpetrating the violence is not acting within his or her organizationally sanctioned responsibilities.

responsibility for the ultimate results of the actions. Within the rational regime of technical expertise, individual conscience is subjugated to professional values. A strictly technical perspective dehumanizes the objects of actions by expressing them in technical, value-neutral terms, thereby allowing them to be viewed in an amoral fashion. As these actions become increasingly quantitatively represented and manipulated, the human subject is further obscured. Administrative evil is perpetuated as the ability for ethical evaluation is lost.

Next, we consider the socializing conditions that facilitate the abdication of moral responsibility by professionals within work organizations. Kleman [1973] postulates three enabling conditions – organizational violence is authorized and sustained by organizational primacy and discipline; action is routinized through role specification and rule-governed practices; and the victim is dehumanized through abstraction and quantification.[9] Moral responsibility arises from being held accountable.[10] The prevailing professional and organizational norms and values dictate the decision rationale.[11] Legitimating criteria are synonymous with instrumentally rational decision making, and moral responsibility is narrowly defined as applying instrumentally rational logic in arriving at, and carrying out, a course of action.

Organizational violence is authorized, often indirectly, through the single-minded pursuit of the ultimate "legitimate" goal(s) of the organization. Within Veblen's critiques of the financial management of corporations, maximizing shareholder value, or some derivation thereof, represents the ultimate legitimizing criterion. However, we would argue that Veblen's reliance on engineering approaches does not ultimately change the maxim of efficiency that drives the organizational structure, although it may be broadened a bit. Regardless of the technological base upon which the criteria are situated, the well-being

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[9] These conditions are not seen to be mutually exclusive. Bauman [1989] has employed these conditions in illustrating how conscientious technicians and administrators facilitated the Holocaust through organizational and technical roles and responsibilities. For a discussion of the role of accounting and accountants see Funnel [1998], Dillard [2003], Lippman and Wilson [2007], Lippman [2009] .

[10] See Roberts [1991, 1996, 2001], Schweiler [1993], Shearer [2002].

[11] We neither assume in this discussion that fixed, immutable foundations exist for making moral choices, nor do we assume that all individuals would reach similar conclusions in similar circumstances. We do suggest, however, that individuals within the organization are empowered to use critical evaluation and critique such that "actors and organizations can evaluate and be held accountable for their actions in terms other than those dictated by instrumental rationality" [Dillard and Ruchala, 2005, p. 618].

of the organization is to be accepted as synonymous with the well-being of the individual, and there must be disciplinary forces to motivate the actors to act in accordance with these goals. The organizational hierarchy controls the distribution of resources. Instrumentally rational decision processes are privileged as legitimizing criteria and, thus, provide the means by which discipline is imposed on individual actors whether financial technicians or production technicians are in control. An instrumental perspective blurs, and ultimately obscures, the moral issues[12] associated with the actions undertaken to satisfy the organization's needs. The hierarchy authorizes the actions; the professionals insure that technically rational knowledge is appropriately applied; and the technology facilitates the efficient and effective disposition of one's duties. All three provide the legitimizing basis for actions and evaluation, and all three mask the potential for organizational violence.

Kleman's second condition facilitating the abdication of moral responsibility routinizes the action through role specification and standardized procedures. Routinization shields the participants from having to confront moral consequences of their actions. At some point, the discipline of narrowly focusing on the technical and administrative details of one's work can create a "taken-for-granted" quality that reduces the capability to question the underlying principles or consequences of one's actions [Baumeister, 1997] and substitutes technical responsibility for moral responsibility. Technical responsibility requires that the best available technology be applied in a cost-effective manner. The means become an end in itself, and the intermediate steps connecting the means with the ultimate outcome are not recognized. The ethical dilemmas associated with the ultimate outcome are not confronted, only the daily ones related to effective and efficient processing.

Dehumanization of the victim represents the third dimension that facilitates the abdication of moral responsibility by eliminating any subjective affiliation with the objects of concern. Phenomena are translated through technology filters into dehumanizing quantitative representations. Those who work within hierarchical control structures are primarily measured on, and therefore interested in, the quantitative impact of their actions. Thus, dehumanization is commonplace with and within

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[12] In fact, the moral issues are presumed to be responsibly addressed by applying a "rational" decision process in evaluating and selecting alternatives. See, for example, Lampe and Finn [1992].

organizations, which are predicated on instrumentally rational manifestations such as bureaucratic control hierarchies.

Our premise is that Veblen rued the use of economic efficiency defined in terms of financial returns within Kleman's first condition (legitimized violence through organizational primacy and discipline); yet, he proposed an alternative organizational goal (technical efficiency) which also enables Kleman's remaining conditions – routinization and dehumanization. The next section explores Veblen's ideas regarding each of these conditions more completely.

VEBLEN'S IDEAS

Raines and Leathers [2001, p. 309] suggest that: "Veblen was the first economist to systematically analyze the social and economic effects of technology on modern culture within the context of large corporate business enterprises." Analyzing the rapid changes in technology and in corporate growth, Veblen's work provides insight into the dialectical relationship between administrative and scientific/physical technology. While we refer to other writings, the primary compilation of Veblen's ideas and the primary source for our analysis is one of his last works, *The Engineers and the Price System* (*EPS*), published in 1921. The following discussion differentiates between the financial and the production technician and their related technologies and provides a general outline of the arguments set forth as to the why and how of the technological imperative within business organizations.

First, we briefly describe the socio-economic context within which Veblen was writing as it relates to our discussion. Veblen was writing in a time of growth and change,[13] such as the growth of productive capacity and industrial capital especially as reflected in the large trusts of the day; the changes and upheaval associated with World War I and the Bolshevik Revolution; and the emerging management-labor relationships across the industrializing world.

Much work considers the context and practice of management accounting during the period in which Veblen was writing in the early 20th century.[14] As Fleischman [2000] points out,

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[13] See, for example, Chandler [1962, 1977, 1990] for discussions of business within this larger context.

[14] See Fleischman and Tyson [2007] for a recent review. See also Johnson [1975a, b, 1978. 1983], Chandler [1977], Johnson and Kaplan [1987], Miller and O'Leary [1987], Hopper and Armstrong [1991],

the different perspectives taken by the various authors lead to somewhat different, though not necessarily mutually exclusive, interpretations. Our discussion presumes that the traditional perspective is grounded in economic rationalism reflected primarily in neoclassical economics [Fleischman, 2000]. The period can generally be characterized by the rise of the vertically integrated mega-corporation and the onset of managerialism exemplified by the work of Fredrick Taylor [e.g., 1912] and scientific management. Not unrelated, standard management accounting and costing systems were emerging [Fleischman and Tyson, 2007] as a means for managing the integrated work organizations and implementing change. Several authors consider the relationship between Taylor's ideas and Veblen's proposals with respect to a technocracy.[15] Bruce and Nyland [2001, p. 955] state that:

> Taylor, an engineer from Philadelphia, emphasized the application of the scientific method to the selection, training, and utilization of workers, highlighting the need for planning and management based on empirical investigation rather than "rule of thumb" or tradition. This emphasis on empiricism and planning found a particularly receptive ear among members of the institutionalist school [Veblen and his disciples], many sharing misgivings about neoclassical economics' deductivist method and its laissez-faire philosophical underpinnings.

Two strands of Veblen's thought are of particular relevance here. First, Veblen draws a clear distinction between "pecuniary" and "industrial" activity.[16] The former are activities characterized as exploitive, predatory, and/or wasteful functions of business, while the latter includes those functions that produce socially useful products and services. Speculation, financial management, and "salesmanship" are examples of the business functions that Veblen cites within the former category. Production engineering and material science[17] are examples of the latter. Using these distinctions, Veblen criticizes the growth of financial capitalism and the dangers of capitalist control over the means of production with their sole focus on growth and wealth

[15] See Nyland [1996]; Knoedler [1997]; Knoedler and Mayhem [1999]; Bruce and Nyland [2001].

[16] This distinction is referred to by Veblen as the ceremonial-technological dichotomy.

[17] Veblen even includes "production economist" in this category.

accumulation (profit) to the detriment of providing the goods and services needed by the members of society.

Veblen's second relevant theme considers the relationship between large corporations and techno-economic change. According to Tilman [2004, p. 8], Veblen attempts to explain "the economic history of the West by linking cultural anthropology and social history with changes in the techno-economic base." Veblen is concerned with agency in the form of cultural malleability, structure in the form of institutional rigidity, and the motivating and moderating influences of technology as they relate to economic activity.

Veblen's criticisms of corporate interests and absentee ownership are well recognized. The implications and modifications associated with large-scale work organizations are more nuanced and debatable. For example, Veblen seems to acknowledge both the positive and negative potential of industry on the lives of the affected workers pointing out the industrial setting's emancipatory impact as well as its mechanistic effects [Veblen, 1919, p. 39; Tilman, 2004]. In *EPS*, Veblen is committed to the "physical" technicians as the group that should control the industrial sector of the economy. He proposes that the conduct of "business" be removed from the "captains of industry" (financial capital) and given to the "production engineers" (scientific technicians).

Veblen's solution is spelled out in Chapter VI of *ESP*, "Memorandum on a Practicable Soviet of Technicians." The central feature is the establishment of a central directorate of "industrial statesmen" composed of a loosely tripartite executive council with power to act in matters of industrial administration. The three primary groups are resource engineers, transportation-system technicians, and distribution-system technicians. The council would be relatively small, supported by presumably larger staffs. The central council would provide guidance and coordination of subcenters and local councils. Veblen envisions constant consultation with accreted spokesmen from the main subdivisions of productive industry, transportation, and distribution traffic. The primary actors are production engineers who exhibit expertise in material processes; that is, the ways and means of producing goods and services and production economists who maintain expertise in planning and resource allocation.

While Veblen's unequivocal denunciation of financial capital is rarely questioned, an equally unequivocal promotion of production technicians is not universally supported by some scholars.[18] We accept Veblen's stated position in *EPS* as representing an important historical perspective on scientific technology and technicians in large organizations that provides the grounds for prevailing attitudes. As such, Veblen's position provides an historical perspective on one dimension of administrative evil that, in general, has become accepted unquestionably within large-work organizations – technology, including its application by technicians, is amoral and this amorality has been confused with "value neutrality." This perspective, we suggest later, obscures the moral implications of an organization's actions and reduces the opportunity to question consequences within the context of the situation. We suggest that Veblen's critique of capitalism and absentee ownership of the means of production led him to propose a technological imperative in which a belief in the material laws of nature qualifies their high priests and disciples to serve as the guardians of society's economic resources.

With respect to accounting technologies and control structures, the role of ideology is central to perpetuating administrative evil through its singular objective of maximizing shareholder wealth. In his last work, *Absentee Ownership* [1923], Veblen elaborates on the evils of financial capital which here include militarism, industrial strife, and "business sabotage." These are manifestations of the inherent conflict embodied within the prevailing socio-economic system that pits the interests of the workers/citizens against those of the financial capitalists. Explicitly, according to Veblen, profits are maximized through unemployment and privation, restricted output, and price inflation. Gesturing toward our conceptualization of implicit administrative evil, Veblen views these conflicts as more a result of the business system's internal logic than moral failings, malice, or greed. "Once money-values are accorded primacy over use-values, once net profit is elevated to the primary goal all else follows" [Spindler, 2002, p. 84]. Next, we consider the two primary groups in Veblen's analysis, the financial capitalists and the production engineers.

Financial Capitalists and Production Engineers: Veblen referred to four broad evolutionary eras of economic development – the savage, barbarian, handicraft, and machine eras. Technological improvements motivated the evolution from the handicraft

[18] For example, some suggest that such a position is out of character with the larger body and spirit of Veblen's work. See Edgell [2001] and [Tilman [2004].

to the machine era in that technological advances facilitated technological processes and increased scales of production that required the development of the industrial plant, the concentration of ownership of the capital assets, and the separation of ownership through the sale of financial capital. The independent, skilled owner-craftsman gave way to the entrepreneurial owner-operator. However, as industrial processes became more complex, Edgell [2001, p. 71] notes: "the entrepreneur withdrew from engagement in the technical aspects to concentrate on the financial aspects. The captain of industry thus mutated into the captain of finance, who has been superseded by the impersonal corporation."

Veblen viewed the management of the corporation as evolving into two dimensions, an administrative (social) dimension and a technical (physical/scientific) one. The administrative dimension referred to the administrative-control hierarchies and the business managers who populated them. The technical dimension referred to the technical systems and the engineers who developed and applied the scientific technology.

Veblen [1921, pp. 55-56] saw administrative evil run rampant with the captains of finance colluding and manipulating in order to "divert whatever they can to the special gain of one vested interest and another, at any cost to the rest." He also itemized the forms of such evil: "the industrial system is deliberately handicapped with dissension, misdirection, and unemployment of material resources, equipment, and man power, at every turn…and all the civilized peoples are suffering privation together because their general staff of industrial experts are in this way required to take orders and submit to the sabotage at the hands of the statesmen and the vested interests."

The Captains of Finance an Instrumental Rationality: Veblen's critique of the bureaucratization of business functions shows remarkable similarity to Kleman's [1973] three conditions discussed above as antecedents of administrative evil. Kleman's first condition, the abdication of personal responsibility, was identified by Veblen [1918, p. 410] in his critique of the "new order." He notes that the corporate structure has severed the employer-owner relationship and has removed owners from responsibility for the actions of the firm: "...the place of the personal employer-owner is taken by a composite business concern which represents a combination of owners, no one of whom is individually responsible for the concern's transactions." He continues on to note that the "chief and abiding power conferred by ownership" is that of being "personally responsible with discretion in all details." However, he argues that corporate capital ownership has taken this power of personal responsibility away from the ownership. "Ownership now has virtually lost this essential part of its ordinary function. It has taken the shape of an absentee ownership of this corporate capital [where] the greater proportion of the owners have no voice."

Veblen also finds Kleman's second condition, depersonalization, occurring for both owners and workers in the corporation of his day. Veblen argues that "The personal equation is no longer a material factor in the situation. Ownership has been… depersonalized to a degree beyond what would have been conceivable a hundred years ago." For workers, "…even that contractual arrangement which defines the workman's relation to the establishment in which he is employed, and to the anonymous corporate ownership by which he is employed, now takes the shape of a statistical reckoning in which virtually no trace of the relation of man to man is to be found" [Veblen, 1918, p. 410]. Veblen saw that these two conditions result in a regimen that manifests a tunnel vision perspective focusing on the ends (profit) rather than the methods of achieving those ends: "… this state of things cannot be charged to anyone's personal account and made a subject of recrimination. In fact, it is not a case for personal discretion and responsibility in detail, but rather for concerted action looking to some practicable working arrangement."

Although Veblen found both the abdication of personal responsibility and dehumanization as problems, he presents a mixed analysis of the routinization of processes, Kleman's third condition facilitating the abdication of moral responsibility. As a strong supporter of Frederick Taylor's scientific management [Knoedler and Mayhew, 1999] and the use of technological improvements, Veblen predicted that increased standardization and mechicanization of process would lead to greater intellectual development on the part of workers. Veblen held out this result as hope for the ability of workers to create social change. The root of the problem then, in Veblen's perspective, was not the use of technology itself but the application of technology in the control of "corporate captains."

Engineers and the State of the Industrial Arts: Veblen believes that the industrial arts can be separated from the "business system's internal logic." Technology is seen as ideologically pure. The problem is not in the nature of the thing, the technology and/or the expertise, but rather who owns/controls them and, more importantly, who receives the returns from their use. In contrast to the lack of value (indeed, evil) Veblen sees in administrative or "ceremonial" management, Veblen [1918, p. 413] holds the state of the industrial arts and the skilled craftsman in high regard. Technological change is a significant driver in moving the society forward. Thus, Veblen views technology as highly productive and as a critical community resource that is limited by the diversion of its use for private gain: "This body of technological knowledge, the state of the industrial arts…constitutes the substantial core of that civilization…It is a joint possession of the community, so far as concerns its custody, exercise, increase, and transmission."

Thus, as a community resource, Veblen [1921, p. 148] argued that the measurement of production should not be based on the accounting measures of profitability and gain but on community benefit:

> Their units and standards of valuation and accountancy are units and standards of price, and of private gain in terms of price; whereas for any scheme of productive industry which runs, not on salesmanship and earnings, but on tangible performances and tangible benefit to the community at large, the valuations and accountancy of salesmanship and earnings are misleading.

Veblen [1921, pp. 148-149] states his position in no uncertain terms. The accountant and businessman are cut from the same cloth and must be excluded under the new order:

> …the experienced and capable business men are at the best to be rated as well intentioned deaf-mute blind men. Their wisest judgment and sincerest endeavors become meaningless and misguided so soon as the controlling purpose of industry shifts from the footing of profits on absentee investment to that of a serviceable output of goods.

This view, with its emphasis on production-related measures, is reminiscent of the criticisms of using financial-accounting measures as the criteria for managing production operations set forth by Johnson and Kaplan [1987].

In his reach for a solution to those vested interests and absentee owners, Veblen [1921, pp. 53-54] suggests in his most controversial work that those who are experts in the physical process, the engineers, are uniquely suited to step in and control the industrial system: "…The industrial system of today…lends

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itself to systematic control under the direction of industrial experts, skilled technologists, who may be called 'production engineers' for want of a better term." Later, in the same text, Veblen (p. 137) states: "The technicians are indispensable to productive industry of this mechanical sort; the Vested Interests and their absentee owners are not."

However, some engineers have compromised their birthright by becoming commercialized and co-opted by vested interests and financiers. These technicians must begin to see themselves differently in order to bring about the new order. They must change their representations of how they fit within the overall system before they can see themselves as able to respond and change. Changes in their representations would then change their values and norms. Conflict could then be created as they tried to acquire power in order to implement their newly found understanding of their role. Although presently in the employ of the ownership class, Veblen [1921, p. 79] asserts that the growth of class consciousness on the part of the production engineers would motivate them to redirect their efforts for the benefit of the broader community good:

> They are, by force of circumstance, the keepers of the community's material welfare; although they have hitherto been acting, in effect, as keepers and providers of free income for the kept classes. They are thrown into the position of responsible directors of the industrial system, and by the same move they are in a position to become arbiters of the community's material welfare. They are becoming class conscious, and they are no longer driven by a commercial interest, in any such degree as will make them a vested interest in that commercial sense in which the syndicated owners and federated workmen are vested interests.

In the 1920s,[19] Veblen worked with an engineer, Howard Scott, and a small number of "progressive" engineers and scientists to form a group called the Technical Alliance. The organization was reformed as "Technocracy Incorporated" in the early 1933 and is currently active.[20] The Technical Alliance caught the attention of the popular press in early 1930s for research

[19] It might be noted that Veblen wrote *EPS* before the 1920s. See publishers note from third printing, 1933.

[20] See its website: www.technocracyinc.org. The website provides access to a study guide that contains, almost verbatim, some of Veblen's analysis and prescriptions.

done over the preceding ten years. Dorfman [1966, p. 511] notes that Veblen was called "the theoretical founder of Technocracy" in magazine articles and his work, *The Engineers and the Price System,* was reissued. Study groups across the country discussed Technocracy's ideas. Dorfman [1966, p. 513] notes that the January 1933 issue of *Nation* magazine editorialized: "Technocracy has performed a genuine service by focusing public interest on the two central problems of capitalist society – machines and money….It has dramitised the problems involved in the displacement of men by machines and the inadequacy of the present system of currency and credit for balancing production and distribution."

Ideology, Technology, and Instrumental Rationality: Veblen's position provides a historical perspective on one dimension of administrative evil, central to accounting, that is generally unquestionably accepted. That is, technology is amoral, and the application of technology to decisions or actions results in an efficient and objective determination. Technology becomes its own ideology. For Veblen an "...ideology that science had the capacity for solving social problems that capitalist institutions left unresolved had great appeal as a counter to the accepted notions about the sanctity of property and wealth…." [Stabile, 1984, p. 15]

Veblen recognized the possible dangers of capitalist control of the means of production with its sole focus on growth and wealth accumulation. As noted above, Veblen proposes that the conduct of "business" be removed from financial capital and given to the "production engineers." While such a move shifts control from a group whose legitimacy is based on the instrumental rationality of capitalist markets to one predicated on the instrumental rationality of "material science," we argue that "production engineering" is a socially constructed technology also predicated and legitimized by its logical grounding in instrumental rationality.

The question arises as to how Veblen's ideas as developed above fit with the applications of instrumental rationality manifest as expertise, technology, and hierarchical control structures discussed in our previous work. Is Veblen's utopian dream just another application without soul, without consideration of the human being, and, thus, another form of administrative evil and its masking? Our understanding of Veblen suggests that all traditional productive activity is so defined such that the contexts of input/output and efficiency constitute the primary criteria of evaluation, and these criteria are formulated and evaluated in terms of production capacity and its utilization. The societal objective of the business sector is to satisfy the needs of the population without waste and duplication of work. Veblen's analysis is directed toward the "primary" industries within society and assumes that the motivations of the engineers are "physical" in that values are grounded in the physical laws of nature or the "physical" laws of economics or society. The scientific grounding of the subject matter as well as their disposition, training, and professional responsibility guide these technocrats. Their rational training and discipline imbue the "production engineer" and related technicians with scientific and disinterested orientation well suited to steward the productive resources of the society. Such a position implies that one cannot take the "laws of nature" and pervert them so that they advantage one group relative to another. The technicians' power arises from their understanding of the productive technology and their ability to apply effectively and efficiently the nation's productive capabilities in the actual transformation of resources into goods and services. The transformations are carried out in a manner consistent with society's needs with regard to both adequate output and gainful employment.

Veblen viewed organizational management along two dimensions, one administrative and the other technical. The administrative dimension referred to the administrative control hierarchies and the managers who populated them. The technical dimension referred to the technical systems and the technicians who developed and applied the scientific technology. Both, we argue, hold instrumental rationality as a, if not the, central legitimating dimension. Veblen is quite critical of the managers who control and implement the administrative hierarchies. On the other hand, he holds the engineers and their technological systems to be proper caretakers of society's means and modes of production. Because of its grounding in physical laws and formal (mathematical) logic, Veblen believed this segment to exhibit different and less self-serving modes of behavior than the politically and socially motivated actions associated with administrative systems. However, Veblen's valorized engineering solutions are still firmly grounded on the legitimizing criteria of instrumental rationality. In fact, because of the link to physical phenomena and laws, instrumental rationality might be even more dominant in this sector. As such, we argue, administrative evil dominates the sector as it is implemented within hierarchical control structures. However, as discussed above, some [*inter alia,* Tilman, 1992] have argued that Veblen recognizes the limitations associated with this technical perspective and that his arguments move beyond the narrow implementation of instrumental rationality, implying organizational arrangements based on the democratic participation of engineers and workers.

Given Veblen's discussion in *EPS*, it is not clear how transfers are facilitated. One might argue that Veblen does not hold the pricing system at fault so much as its manipulation by the captains of finance, although he does seem to be inclined towards use values over money values. The pricing system is not bad, per se, but it has been co-opted, and controlled. The markets are no longer free but controlled and manipulated by the vested interests through their uncontested control over the economic resources of the nation and the political system that has been co-opted and corrupted. This state of affairs is perpetuated by apathy and acquiescence on the part of the technicians. Central to Veblen's analysis is that the total control of the means of production by the engineers can be legitimized by the argument that they are grounded in and held accountable by the laws for nature. They are not soiled by desires/emotions of self-interested, pecuniary-motivated human beings and possess the ability, disposition, discipline, and training to move beyond such "irrational" or self-centered motivations.

Efficiency is a key legitimating factor underlying the justification and structure of Veblen's technician-centered program from two perspectives. One relates to the exercise of control over the industry system by vested interests, and the other arises out of the inability of non-technicians to deploy society's economic resources efficiently. Withholding efficiency represents the primary means whereby vested interests exercise control for personal wealth [Veblen 1921, pp. 9-10]. This ability to pervert the market system for gain has arisen with the ascendancy of the corporate financer.

On the other hand, inefficiencies also emanate from businessmen's lack of technical knowledge. Veblen [1921, p. 121] argues that this lack of knowledge creates significant and costly inefficiencies throughout the industrial system:

> It is true, if the country's productive industry were competently organized as a systematic whole, and were then managed by competent technicians with an eye single to maximum production of goods and services; instead of, as now, being manhandled by ignorant business men with an eye single to maximum profits; the

> resulting output of goods and services would doubtless exceed the current output by several hundred per cent.

Moving away from an industrial structure based on absentee ownership and financial capitalism toward a more technocratically managed industrial sector would alleviate the problems of efficient production of an adequate level of goods and services; provide for economic deployment of the society's productive resources, with full employment of labor being a primary concern; and facilitate the equitable distribution of consumable output.

No Panacea for Administrative Evil: Technicians and the associated technology are not panaceas for administrative evil. While Veblen's ideas are not without logic and appeal, we believe his proposal substitutes one manifestation of administrative evil for another. It replaces the application of instrumental rationality to social relationships with the application of instrumental rationality of physical relationships. In fact, such a shift may be even more disempowering for two reasons. First, legitimation appealing to physical laws is more difficult to challenge because of the implied grounding in the "objective laws of nature."[21] Second, singular appeals to the technical and the technician obscure the social relationships that underpin them. Within such a system, technical rationality replaces moral responsibility.

A presumption of efficiency underlies Veblen's technician-oriented industrial sector. Within an environment characterized by limited resources, only the efficient survive. Individual actors providing goods and services gain efficiency in their undertakings through the application of instrumental rationality manifested as technology, expertise, and hierarchical-control mechanisms. The economic system reflects the composite of individual actions adhering to and following from the application of instrumentally rational techniques and technologies by trained technicians.

Tilman [1992, p. 202] states that Veblen "did not adequately differentiate between an ability to understand means-ends congruence and master technical skills, on the one hand, and the capacity to engage in acts of critical rationality on the other hand." Both an example and a consequence of this lack of differentiation can be seen in Veblen's [1919, p. 37] view of the effect of machine-operated processes on workers:

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[21] See Latour [1987, 2004] for a discussion of the power of science in the conduct of modern society.

> Under the new order of things the mechanical equipment – the 'industrial plan'—takes the initiative, sets the pace, and turns the workman to account in the carrying-on of those standardized processes of production that embody this mechanistic state of the industrial arts; very much as the individual craftsman in his time held the initiative in industry….

Veblen [1919, p. 39] suggests that the effect of these changes in the institutional structure of work have implications on workers, predicting these interactions with machine technology would lead to greater rational and intellectual development and consciousness on part of workers, motivating a heightened collectivist mentality, and the ability of workers to create radical social change.

Stabile [1984, pp. 205, 210] disagrees with Veblen's view of the effect of technological processes on workers, suggesting that Veblen never considered that the capitalists would find ways to use the technology to control workers through deskilling and technical control. These are evil in that they deprive human beings of their dignity. In addition, Stabile argues that "Veblen posited a version of socialism that demanded worker acquiescence to the dictates of technical experts…Veblen made it plain that the economy be governed by a national council, and industrial town meeting." Thus, implicit in Veblen's proposal is the presence of bureaucratic structures. The mechanical metaphor of the production engineers includes hierarchical-control structures. Thus, there is a reinforcing interaction within Veblen's proposed "solution" to capitalist control.

We present these as analogous to the cornucopia of technocratic suggestions for overcoming the shortcomings and inequities of capitalism and believe that such "remedies" will only shift the genesis of the forces depriving innocent human beings of their humanity. Veblen appears to give technology a non-ideological or a neutral character while implicating the ideological nature of administrative-control structures and administrative expertise associated with the vested interests of financial capitalism. We argue that neither of these provides legitimate grounds for privileged control because they are both legitimated by instrumental rationality.

A number of Veblen's contemporaries (e.g., John Commons and Wesley Mitchell) as well as a number of later critics, some of whom are mentioned above, view Veblen as a technocratic elitist for his unbridled faith in the role of technological experts to define and lead the vanguard to a "good society." Some more recent scholars, notably Stabile [1984], Edgell [2001], and Tilman [2004] consider Veblen better described as a "scientific collectivist" although for slightly different reasons. Tilman [1996] reasons that *The Engineers and the Price System* represents a departure from the main body of Veblen's work and the emphasis on a technical elite is not consistent with his prior or later emancipatory focus. He also suggests that we might view his choice of engineers as an "expository device," a contrast to the critique of other organized business groups.

Edgell [2001, p. 155] emphasizes Veblen's role as a social utopian who emphasized cooperation and collectivism. Throughout Veblen's writing, there is an emphasis on workmanship as an inherent, even spiritual, trait in human culture. Edgell argues that "Veblen's utopian vision also privileged work, or as he put it, the machine process, not in a narrow technocratic way, but in a 'broader and more humanistic' manner in which people liberate themselves from the restrictions of pecuniary control of industry and create a new society."

Stabile [1984] compares Veblen's technological collective to that of Lenin. He suggests that Veblen's engineer-worker alliance draws from the latter's peasant-worker alliance. In part, this alliance also comes from Veblen ruling out other interests within society. Veblen argued that neither capitalism and its vested interests nor organized labor was able to adjudicate the best interests of the broader community. Veblen also recognized that the industrial worker was captured by the values of the leisure class, and he became discouraged about the prospects for social change emanating from this group. Stabile notes that Veblen would have been influenced by reformist engineers, such as Herbert Spencer, who were active at the time and may have looked to this group as the only remaining group able to overturn the existing social order.

A Critical Reassessment: Technology is the physical manifestation of instrumental rationality. By engaging Marcuse's [1941] ideas on technology, we consider the developmental relatedness between instrumental rationality and its various manifestations, with technology and technicians being of particular interest. In doing so, we illustrate how Veblen's technocracy is also grounded in instrumental rationality and, thus, embodies the potentiality of administrative evil.

While Marcuse [1941, p. 414] does not address administrative evil explicitly, he certainly grasps its essence and origin. Marcuse provides an analysis of technically based programs such as the one proposed by Veblen and shows that the conception of rationality proves useful in anticipating the negative potential of the pervasive drive toward efficiency. His description of Germany's National Socialist regime is a pre-eminent example of how technology can be appropriated by vested interests (e.g., fascist regimes, financial capitalists):

> National Socialism is a striking example of the ways in which a highly rationalized and mechanized economy with the utmost efficiency in production can operate in the interest of totalitarian oppression and continued scarcity. The Third Reich is indeed a form of 'technocracy': the technical considerations of imperialistic efficiency and rationality supersede the traditional standards of profitability and general welfare...The reign of terror is sustained [in part]…by the ingenious manipulation of the power inherent in technology…follow the lines of greatest technological efficiency.

Marcuse conceives of technology as embodying both technical and social dimensions, implications, and consequences. He describes the process of how the drive for individual rationality can evolve from the promotion of critical thought to become "an instrument of control and domination":

> Individualistic rationality was born as a critical and oppositional attitude that derived freedom of action from the unrestricted liberty of thought and conscience and measured all social standards and relations by the individual's rational self-interest. It grew into the rationality of competition in which the rational interest was superseded by the interest of the market, and individual achievement absorbed by efficiency. It ended with standardized submission to the all-embracing apparatus which it had itself created. …Such was the logical outcome of a social process which measured individual performance in terms of competitive efficiency.

It is interesting that the process set out by Marcuse also has implicit strands of the process set forth earlier in this paper as that enabling administrative evil and suggests, contrary to Veblen's belief, that technical efficiency, in particular, can have disempowering effects on those who are caught within its influence. While Veblen thought that the increased use of scientific processes and technology might increase the critical faculties of workers, Marcuse [1941, p. 422] suggests that such rationality controls and limits the ability of workers to critically evaluate their situation:

> Rationality is being transformed from a critical force into one of adjustment and compliance. Autonomy of reason loses its meaning in the same measure as the thoughts, feelings and actions of men are shaped by the technical requirements of the apparatus which they have themselves created. Reason has found its resting place in the system of standardized control, production and consumption. There it reigns through the laws and mechanisms which insure the efficiency, expediency and coherence of this system.

Following Marcuse, we conclude that a program, and attitude, such as advocated by Veblen's "cult of efficiency" created and sustained by technicians and supported by accounting technologies, is itself the result, and perpetrator, of a technical rationality that provides the legitimating grounds, sustenance, and structure for administrative evil.

DISCUSSION AND CONCLUSIONS

We set out to explore an historical perspective on the roles of ideology and technology in understanding administrative evil within large business enterprises. Thorstein Veblen's work is relevant because he represents one of the first to undertake a critical analysis of large business organizations as they formulate and promote technology in an industrial society. A critic of corporate society's vested interests, he views absentee ownership and financial management of corporations as the source of what we have termed administrative evil. At the same time, Veblen is a strong advocate of technology as the force for positive change within the economy and within the larger human society. Veblen proposed that the rationality of material science as practiced by production engineers is fundamentally different from the rationality of market capitalism. While at one level we agree, at a more fundamental level we find the validity of this claim to be wanting and, thus, are not inclined to modify our previous contentions regarding the propensity of accounting as a facilitating technology for administrative evil.

An analysis of Veblen's ideas provides an historical perspective on a generally accepted perspective that accounting and accounting information systems are amoral applications of instrumentally rational technologies. We argue that Veblen's perspective on technology as set out in *The Engineers and the Price System* is an example of an implementation of instrumental rationality, and that his ideas are seen as part and parcel of a technocratic view of society in which science and technological experts occupy a privileged role that limits the development and expression of alternative value structures and work processes.

Veblen's position is based on the primacy of efficiency in production and distribution. The logic of efficiency is instrumental rationality and is seen by some contemporary business and accounting historians as central in the evolution of business and, thus, society. For example, Chandler [1977] concludes that the form of the modern business enterprise emerged as the result of management-control hierarchies being more efficient than market mechanisms in the manufacture and distribution of goods and services. Veblen would presumably be supportive of at least some of Johnson's [2000] ideas surrounding management by means. While we see definite advantages to Johnson's proposals that claim efficiencies and science as the grounds and template for proposed improvements, our analysis of Veblen's ideas leads us to caution that the specter of administrative evil cannot be ignored and may, in fact, be more insidious as it is masked by the purposed amoral legitimacy of technology and those who apply it.

Our historical analysis of Veblen's work draws attention to the differences between financial technologies (and technicians) and production technologies (and technicians). Specifically, the distinctions illustrate how physically grounded technology is predicated on instrumental rationality and is, therefore, just as imbued with destructive potential as the pecuniary perspective condemned by Veblen. We propose that Veblen's "physical" efficiency morphs from a means to an end. Efficiency becomes a fetish replacing profit as the objectified, legitimating criteria for action. As Roy [1997] argues, efficiency acts in concert with or as a means of power.[22] Veblen's program replaces profit with efficiency as the primary legitimating factor. As such, one inhumane legitimating criterion is substituted for another, with the proposed alternative potentially being more insidious than the one being replaced because of its perceived objectivity and scientific validity, both of which silence debate [Latour, 1987, 2004]. Veblen perpetuates the devotion to technology and technicians spurred by the enlightenment predicated on a mythical faith in technology and its ability to supersede the vagaries of social construction. But ultimately, the potential for administra-

[22] A complete evaluation of Veblen's program requires a more in-depth treatment of the power relationships implied than is possible within the context of the current discussion.

tive evil realized as instrumental rationality, in whatever form, replaces moral responsibility.

While initially optimistic, we find Veblen's work rather narrowly based on enlightenment thinking taken to an extreme conclusion reflecting the program of a disillusioned utopian grasping at technical rationality in order to overcome the despicable situation wherein a few with power (the vested interests) exploited the many. Unfortunately, his panacea turns out to be a placebo, a placebo that may actually advance the disease for which it is a purposed cure. The legitimizing ground for both market capitalism and technocracy is an instrumentally rational conception of efficiency. The presumed socio-political system for both is democracy. Efficiency so defined does not conceptualize human beings as ends in themselves but as means for producing and consuming goods and services. Capitalism is based on a social science (economics), and technocracy is based on physical science (engineering). Within the context of modernity, scientific trumps social. More credibility (truth value) is attributed to physical science. From this perspective, Veblen's recommendations would be deemed preferable to the prevailing alternatives. However, for the reasons presented above, we are not compelled to ameliorate your previous understandings of administrative evil.

We do not wish to engage in debating a preference for the exclusive domination of either market capitalism or technocracy. Our purpose has been to illustrate the inherent potential for administrative evil in both by recognizing its potential within technology such as accounting, expertise such as accountancy, and the administrative hierarchies supported by both, although the manifestations may take significantly different forms. We find Veblen's position and arguments to be, in some ways, a precursor to cure-alls being offered for improving accounting and business practices that are grounded in and legitimated by appeals to their conformity with or emanation from scientific laws and logic. For example, activity-based costing and its management derivative, activity-based management, are presented as a means for providing a more accurate representation of product costs by more faithfully structuring measurement regimes with respect to the underlying physical activities that consume resources. The legitimating grounds are the instrumentally rational scientific processes whereby the technology is derived as well as the decision processes that they support. Human beings, if explicitly considered, are means to an instrumental end. The accounting procedure does not explicitly consider human beings, much less view them as ends in themselves. This, we argue, is the root of administrative evil. Processes and artifacts thus created can be constructively employed, but vigilance is necessary to overcome the dehumanizing potential.

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TRACING THE DEVELOPMENT OF ACCOUNTING THOUGHT BY ANALYZING CONTENT, COMMUNICATION, AND QUALITY IN ACCOUNTING RESEARCH OVER TIME

Abstract: This paper analyzes the longitudinal development of accounting thought by characterizing the content of accounting research over several decades (1963 to 2003). The paper also investigates the interaction among accounting scholars and examines the relationship of research quality, topical coverage, methodological tools, and citation behavior. Thus, this analysis describes how accounting research has evolved, both in its content and in the way it has been used and perceived by its adherent scholars.

INTRODUCTION

The motivation for this study is to improve our understanding of the relationships exhibited in academic research over a period of several recent decades. This paper represents a study of accounting research as embodied in three scholarly accounting journals (*Contemporary Accounting Research, Journal of Accounting Research,* and *The Accounting Review*) as related to the objective of improving our understanding of this literature by employing a set of taxonomic properties in our analysis about the content and context of said literature. Further, this study characterizes the content of accounting research, the communication of this research through the interaction among account-

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ing scholars, and how both this content and this interaction help define research quality. By this characterization, the paper seeks to provide a conception of how accounting research has evolved over time based on the efforts of those who produce, use, and evaluate it. The paper also seeks to improve our understanding of the topical and methodological content of accounting literature and in this way contributes to the literature of the history and development of accounting thought.

The content of accounting research is described by a taxonomic analysis of its topical and methodological characteristics. Taxonomic (Greek "taxis" + "nomia" = arrangement + method) analysis is a method of systematically classifying and arranging items according to their attributes. Therefore, the content of accounting research is defined by classifying the artifacts of the research; that is, papers published in scholarly journals according to what topics these papers cover and what methods their authors used to gather data and arrive at conclusions.

The interaction among accounting researchers is characterized by citation analysis. Citation analysis identifies which research papers have been referenced in other research papers, and thereby endeavors to trace the development of ideas, to chart the interdependencies between groups of researchers, and to evaluate the influence of particular research papers, organs, or paradigms.

Finally, this paper explores the possibility of a new measure of research quality based on the content of research over several years and the citation patterns that have developed over time. This measure would be comprised of a component measuring the diversity of the research content and a component measuring the degree of integration of that research. As discussed later, both these characteristics may be correlated with research quality.

Taxonomic Analysis Defined and Exemplified: The philosopher Thomas Kuhn [1962, pp.16-17] proposed the idea that all research is characterized by "intertwined theory and methodological belief." Therefore, one way in which research may be defined and described is by identifying its topical foci and methodological techniques. Consequently, taxonomic analysis, which classifies artifacts according to their salient characteristics, will be used to profile the content of accounting research by identifying its topical and methodological attributes.

Several accounting history research papers have taken the form of taxonomic studies of literature by analyzing papers according to certain topical or methodological attributes. These include Haseman [1978] who concentrated on management accounting literature; Vasarhelyi *et al*. [1988] who studied papers published in *Contemporary Accounting Research*; Parker [1988], Carnegie and Potter [2000], and Fleischman and Radcliffe [2005] who focused on accounting history studies; Previts and Brown [1993] who categorized papers published in the *Journal of Accountancy*; Fleming *et al*. [1990, 1991, 2000] and Rodgers and Williams [1996] who chronicled research in *The Accounting Review*; and Gamble *et al*. [1995] who studied the accounting education literature.

Citation Analysis Defined: Biochemist Eugene Garfield [1964, 1975, 1994] pioneered citation analysis, asserting that there exists a "conceptual association of scientific ideas as recognized by...research authors" and that "by the references they cite in their research papers, authors make explicit linkages between their current research and prior work in the archive of scientific literature" [Garfield, 1994]. Thus, citation analysis can be used to describe a research network by contextualizing its constituent parts and finding out how different papers or journals interact and inform one another.

However, citation analysis can also be used not merely to describe research but to evaluate it. Examples of accounting research papers taking the form of citation analyses are McRae [1974], Dyckman and Zeff [1984], and Bricker [1988]. Examples of non-accounting citation studies include Bush *et al*. [1974], Hamelman and Mazze [1974], Eagly [1975], Ederington [1979], Liebowitz and Palmer [1984], Alexander and Mabry [1994], Borokovich *et al*.[1995], and Borokhovich *et al*. [1999] who used citation analysis to determine which journals or papers dominate others. In these papers, the extent of this hegemony is commonly measured by a metric derived from the frequency that a journal or paper is cited in other research. Articles that are cited more frequently are assumed to have a greater impact on the literature.

Hence, citation analysis can be used in two ways. First, it may be used as an evaluative metric to determine the influence a journal or paper has on researchers. Second, citation analysis can be used to describe the degree of integration of research outlets which, as discussed later, is a desirable characteristic.

Uses of the Gini Metric: Econometrist Corrado Gini pioneered a statistical measure of diversity in a series of papers in the early

20th century [Stigler, 1994]. This measure, eventually named the Gini metric, captures the extent to which a population is evenly or unevenly distributed among sub-categories within the population. In the past, the Gini metric has been used to see how diversely a nation's exports were dispersed among different foreign trading partners, or how evenly wealth was distributed within populations. However, in this paper, the Gini metric is employed to gauge the diversity of topics and methods in accounting research.

METHODOLOGY AND RESULTS

Overview of Data and Data Sources: Because the ultimate objective of this paper is to determine the content and context of accounting research through taxonomic and citation analysis and to employ a combination of the two to help evaluate the quality of the research, the data used will be of two types. The first comprises the taxonomic profiles of three accounting research journals, and the second summarizes the citation patterns among these journals.

The journals studied in this paper are *Contemporary Accounting Research* (CAR), *Journal of Accounting Research* (JAR), and *The Accounting Review* (TAR). These particular research organs were selected because they purport to be interested in accounting research in general, as borne out by their self-professed research interests and by their empirically determined taxonomic profiles [Badua, 2005].

One way of quickly determining the topical focus of a journal is by reading its editorial statements [Brown *et al.*, 1987]. A review of the editorial policies of 11 different accounting research journals in the Rutgers Accounting Research Database (ARD), in which information is compiled regarding scholarly journal papers published between 1963 and the present, revealed that CAR, JAR, and TAR were self-identified as journals that would accept papers from a broad array of accounting research topics. In contrast, the eight other journals had a self-admitted focus on specific topics such as financial accounting or information systems. Thus, even though other journals such as *Journal of Accounting and Economics* or *Auditing: A Journal of Theory and Practice* may be considered dominant and influential journals because of their specific research foci, they are excluded from this study.

Hence, JAR, TAR, and CAR comprise a general purpose journal group, one that could be characterized as being more broadly based in its selection of accounting research with papers spanning a relatively wider range of topics than the other journals. Therefore, it may be stated that the taxonomic and citation characteristics of CAR, JAR, and TAR would be representative of the accounting mainstream, and that findings as to the content and context of research published in these journal would be generally applicable.

Methods for Gathering and Analyzing Data for Taxonomic Analysis: The research attributes of interest in this paper are the topical emphases and methodological techniques that characterize accounting research as embodied by the three journals identified in the previous section. These attributes are determined by classification according to the Rutgers ARD. The most recently published hardcopy implementation of the ARD appeared in third edition in 1994 [Gardner *et al.*, 1994].

The ARD taxonomic schema is comprised of 12 different categories which collectively describe various aspects of a paper's topical foci, methodological tools, and other characteristics such as its geographic setting, probable applicability, etc. However, this paper will focus on five particular taxonomic categories which collectively describe the topical and methodological attributes of accounting research. The three topical taxons are accounting area, school of thought, and foundation discipline, and the two methodological taxons are research method and mode of reasoning.

Accounting area defines the functional realm of accounting practice to which the paper contributes. Included are financial accounting, auditing, managerial accounting, taxation, and mixed areas.

The school-of-thought taxon identifies the major area of accounting research to which the paper contributes. This taxon is unique in that the categories that comprise it are not common to those of other fields. That is, these taxonomic categories are mostly specific to accounting research. These areas include human information processing (HIPS), efficient market hypothesis (EMH), time series, mathematical programming, information economics, agency theory, institutional studies, expert systems, and accounting history.

The foundation-discipline taxon identifies which academic area provides the intellectual basis for the paper. This taxon includes psychology, sociology, political science, history, philosophy, economics and finance, engineering, communication, computer science, mathematics, decision theory, game theory, statistics, law, accounting, and management.

Taxonomic classification according to research method is intended to identify which data-gathering procedures underlie the research paper. Three broad areas of research method exist – analytical, archival, and empirical. Analytical studies may use internal logic or simulations. Archival studies use either primary records (annual reports, accounting records, and aggregated database sources, e.g., CRSP and Compustat) or secondary records (other research papers or analyses of primary data, such as forecasts). Finally, empirical studies may take the form of case studies, field studies, laboratory experiments, or surveys.

Taxonomic classification according to mode of reasoning determines which type of quantitative or qualitative analysis technique was used to formally arrive at the conclusions of the paper. These various techniques include descriptive statistics, regression, analysis of variance (ANOVA), factor analysis, non-parametric statistics, correlations, and qualitative analyses.

In order to capture the topical and methodological characteristics of accounting research, each paper of at least five pages in length from the three selected journals were manually inspected. Shorter papers, as well as editorial commentary, letters to the editors, discussions of papers, and book reviews were excluded. Each of the selected papers was read and then classified according to the various classifications comprising the five chosen taxonomic categories. In this way, the major topical and methodological attributes of accounting research as represented by the three sample journals were determined.

Once these papers had been classified, the number of papers categorized under each particular taxonomic classification was determined, and that number divided by the total number of papers published in the journal in which the paper had appeared. Counts were made and proportions computed over all years from 1963 to 2003. Hence, the proportions of papers exhibiting a particular topical or methodological characteristic were determined for all three journals in all years the journal had been in existence through 2003 (TAR papers since 1963 only were included although the journal has been published since 1926). Thus, the data run from 1963 to 2003 for JAR and TAR and 1984 to 2003 for CAR. These annual proportions are in effect a summary of the content of the entire publishing life of JAR and CAR and slightly more than half that of TAR up to 2003. Taken in aggregate, these proportions may be said to summarize the evolution of the mainstream of accounting research over the last four decades of the 20th century.

Results from Analysis of Individual Taxons: Table 1 summarizes the proportions that different research methods comprise articles in each of the three journals. The research methods reflected in CAR and JAR are predominantly primary archival studies (48.8% and 35.95% respectively) and internal logic (34.8%, 31%). TAR authors similarly utilize these two research methods except that there is a greater dependence on internal logic (38.95%) than primary archival studies (28.15%). CAR's third most frequently deployed research method is secondary archival (7.5%), differing from JAR and TAR where laboratory studies (14.22%, 12.54%) are the third most common research method of choice.

This finding indicates that the three journals predominantly use the same data-gathering methods, except that JAR and TAR depend on laboratory studies more than CAR. This difference may indicate a behavioral focus in the former two journals that is absent in the latter.

TABLE I

Percentages of Papers Using Various Research Methods

	CAR (x/518)	**JAR (x/1207)**	**TAR (x/1771)**
research method: internal logic	34.80%	31.00%	38.95%
research method: simulation	1.55%	3.49%	2.61%
research method: archival primary	48.80%	35.95%	28.15%
research method: archival secondary	7.50%	7.83%	9.71%
research method: case studies	1.15%	1.44%	1.24%
research method: field studies	0.65%	2.66%	2.59%
research method: laboratory	2.30%	14.22%	12.54%
research method: survey	2.45%	2.85%	3.88%
research method: mixed	0.95%	0.80%	0.39%

As revealed in Table 2, CAR, JAR, and TAR all depend predominantly on regression analysis as a mode of reasoning (32.85%, 28.78%, 23.56%). However, while JAR's second most utilized mode of reasoning is analytical modeling (23.22%), CAR and TAR authors favor qualitative reasoning (23.5%, 22.61%). The third most frequently used modes of reasoning for the three journals are descriptive statistics for CAR (13.5%), qualitative reasoning for JAR (10.46%), and analytical modeling for TAR (20.39%). The salient finding in this distribution is that while analytical modeling was among the top three modes of reasoning for JAR and TAR, it was not for CAR. This may indicate that JAR and TAR play the role of theory building in the accounting research network.

TABLE 2

Percentages of Papers Using Various Modes of Reasoning

	CAR (x/518)	JAR (x/1207)	TAR (x/1771)
mode of reasoning: descriptive statistics	13.50%	10.02%	9.17%
mode of reasoning: regression	32.85%	28.78%	23.56%
mode of reasoning: ANOVA	2.90%	10.05%	10.10%
mode of reasoning: factor analysis	3.15%	3.10%	2.71%
mode of reasoning: markov analysis	0.15%	0.32%	0.17%
mode of reasoning: nonparametric statistics	2.20%	5.90%	3.73%
mode of reasoning: correlations	1.95%	2.17%	1.78%
mode of reasoning: analytical modeling	11.80%	23.22%	20.39%
mode of reasoning: mixed	8.40%	6.37%	5.39%
mode of reasoning: qualitative	23.50%	10.46%	22.61%

Table 3 demonstrates that CAR and TAR authors devote themselves more heavily to the study of accounting theory (26.2%, 22.15%) while JAR's primary school of thought is the

TABLE 3

Percentages of Papers Studying Various Schools of Thought

	CAR (x/518)	JAR (x/1207)	TAR (x/1771)
school of thought: human information processing	1.10%	9.93%	8.85%
school of thought: other behavioral	1.05%	7.88%	9.00%
school of thought: efficient markets hypothesis	22.40%	22.59%	17.56%
school of thought: time series	3.35%	5.12%	3.34%
school of thought: information economics	4.25%	10.44%	7.20%
school of thought: mathematical programming	0.60%	2.05%	3.44%
school of thought: other statistical models	10.85%	14.71%	12.54%
school of thought: accounting theory	26.20%	15.07%	22.15%
school of thought: accounting history	0.70%	2.32%	2.54%
school of thought institutional	13.15%	2.59%	5.73%
school of thought: other	16.05%	5.12%	7.10%
school of thought: agency	0.40%	2.39%	0.78%
school of thought: expert systems	0.25%	0.27%	0.12%

EMH (22.59%). CAR and TAR authors also focus on efficient markets as their second most studied school of thought (22.4%, 17.56%), while for JAR, accounting theory is the second most studied topic. Finally, the third most frequently studied school of thought for CAR is other topics (16.05%) and for JAR and TAR (14.71%, 12.54%), other statistical models. These results reveal a migration to the EMH as a research topic, consistent with previous research on accounting scholarship [Maher, 1997].

Table 4 reveals consistency in both the first and second most referenced foundation disciplines among the three journals. These foundation disciplines are accounting (CAR=45.35%, JAR=39.39%, and TAR=43.1%) and economics and finance (CAR=36%, JAR=26.98%, and TAR=22.12%). However, there is less consistency in the third most utilized foundation discipline with CAR authors favoring law (5.8%) and their JAR and TAR counterparts choosing psychology (12.95%, 10.24%). These findings are again consistent with earlier results regarding research method as JAR and TAR authors were frequent users of laboratory studies, indicating a behavioral emphasis as confirmed by their frequent use of psychology as a theoretical grounding.

TABLE 4

Percentages of Papers Based on Various Foundation Disciplines

	CAR (x/518)	JAR (x/1207)	TAR (x/1771)
foundation discipline: psychology	1.30%	12.95%	10.24%
foundation discipline: allied humanities	1.30%	3.15%	3.85%
foundation discipline: economics and finance	36.00%	26.98%	22.12%
foundation discipline: computer technology	0.15%	0.85%	1.90%
foundation discipline: allied mathematics	3.05%	10.12%	6.85%
foundation discipline: statistics	2.80%	3.15%	3.98%
foundation discipline: law	5.80%	0.27%	1.56%
foundation discipline: mixed	2.35%	2.10%	1.88%
foundation discipline: accounting	45.35%	39.39%	43.10%
foundation discipline: management	1.95%	1.27%	4.27%

Table 5 shows that all three journals feature financial accounting as their primary area of research (CAR=46.91%, JAR=56.5%, and TAR=51.27%). CAR and JAR authors focus on auditing (27.8%, 17.9%) and managerial accounting (15.06%, 16.4%) as their second and third foci respectively. TAR authors reverse this ordering, focusing instead on managerial accounting (19.88%) and audit (15.3%) as their secondary and tertiary accounting areas of study.

TABLE 5

Percentages of Papers Contributing to Various Accounting Areas

	CAR (x/518)	**JAR (x/1207)**	**TAR (x/1771)**
accounting area: tax	3.09%	2.65%	4.18%
accounting area: financial	46.91%	56.50%	51.27%
accounting area: managerial	15.06%	16.40%	19.88%
accounting area: audit	27.80%	17.90%	15.30%
accounting area: information systems	0.19%	0.75%	1.36%
accounting area: mixed	6.95%	5.80%	8.02%

Results from Analysis of Taxonomic Combinations: Each research paper's characteristics may be described as the combination of taxonomic classifications that apply to that paper. For example, every paper may be characterized by its topical focus (school of thought), its mother discipline (foundation discipline), the function of accounting to which it contributes (accounting area), and the ways by which data are gathered and analyzed (research method and mode of reasoning). Therefore, by analyzing not just the frequencies of use of individual taxons but also the frequencies of various combinations of them, can an analysis of the type of research study most frequently undertaken by accounting scholars be possible.

Cross-Sectional Analysis of Taxonomic Combinations: To determine what types of research most characterize accounting scholarship, composites of the taxonomic characteristics for all papers in the population were constructed. Then, the frequencies of those composites were computed. According to this analysis, the three types of research paper that have been most often attempted over the period of study are:

Papers, that study accounting theory, utilize accounting as a foundation discipline, use internal logic and qualitative argumentation, and contribute to financial accounting (198 papers out of 3,496 in the population that match the ARD selection criteria, or 6% of total papers).

Papers, in which the EMH is studied, are grounded in economics and finance concepts, gather data from primary archival sources, analyze the data using regression statistics, and contribute to financial accounting (185 papers, or 5%)

Papers, in which the EMH is studied, are grounded in accounting as a foundation discipline, use primary archival sources and regression statistics to gather and analyze data, and contribute to financial accounting (130 papers, or 4%)

It could be argued that though there are three groups of papers comprising the list above, these papers actually fall into two categories as the latter two groups may be combined together.

The first cluster of papers is characterized by its focus on accounting theory which is the basic role and fundamental principles of accounting functions and phenomena in relation to industry and the socio-economic milieu. These papers are therefore based on accounting as a foundation discipline, referencing mostly other papers focusing on accounting. In addition to having a distinctive topical focus, the first cluster of papers also has a characteristic methodological approach as well. Rather than gathering empirical data to generate and confirm their findings, authors of these papers use internal logic to do so, deducing from axioms or prior theory to arrive at conclusions. Furthermore, authors of this category of papers use qualitative, verbal argumentation to support their findings which, in addition to mathematical modeling, is one of two modes of reasoning available to works employing internal logic as a research method.

The second category of papers, comprising the second and third groups above, has a very specific topical focus, the EMH. Hence, these papers concern whether and to what extent equity and debt capital markets are affected by accounting information and the manner and timing of its disclosure. These papers are also distinctive in their methodology, based as they are on archival sources, such as the CRSP and Compustat databases for information, and regression statistics for data analysis. The sole difference between the two groups of papers that constitute this cluster lies in their divergent foundation discipline. The second group of papers from the list above feature economics and finance as a foundation discipline while the third group relies upon accounting. Therefore, while the former uses concepts, frameworks, and techniques based in economics and finance research, the latter uses those prevalent in the accounting literature.

Longitudinal Analysis of Taxonomic Combinations: While the preceding analysis permits a summary characterization of the salient features of accounting research, it gives no indication of the longitudinal evolution of these features. Thus, to provide a means of determining how various types of research have become predominant or yielded to other types over the years, the annual frequencies of papers for each of the taxonomic composites was computed. Then those taxonomic combinations whose frequencies comprised the 99.5th percentile were identified (that is, taxonomic combinations whose frequencies were greater than 99.5% of the frequencies of all other combinations). While it would have been possible to identify the top X most frequently encountered combinations, identification of the Xth rank would be problematic since the number of taxonomic combinations varies for each journal and for each time period. Consequently, determination of the top X composites would be meaningless. On the other hand, the use of the 99.5th percentile to screen for extreme values is a common practice, used in fields as diverse as psychometrics and environmental protection [Ohio EPA, 1997]. Therefore, focusing on the combinations comprising the 99.5th percentile would consistently capture the most dominant combinations, no matter how many there were.

This procedure was done for four distinct time periods (1963 to 1973, 1974 to 1983, 1984 to 1993, and 1994 to 2003) for both the total population of papers in all three journals and for each one of the journals individually. The tables below list the dominant taxonomic combinations as determined above.

TABLE 6

Top Taxonomic Combinations All Journals, 1963 to 1973

all journals (1963 to 1973)	school of thought	foundation discipline	research method	mode of reasoning	accounting area
178 of 938 papers	accounting theory	accounting	internal logic	qualitative	financial
22 of 938	math programming	allied mathematics	internal logic	analytical	managerial
17 of 938	accounting theory	economics and finance	internal logic	qualitative	financial
16 of 938	accounting theory	accounting	internal logic	qualitative	mixed
15 of 938	accounting theory	economics and finance	internal logic	analytical	financial
15 of 938	accounting theory	accounting	archival primary	regression	financial
15 of 938	accounting theory	accounting	internal logic	analytical	financial

The first table depicts the dominant taxonomic composites for all journals in the time period 1963 to 1973. These 7 combinations are so frequently encountered in the set of papers that their frequencies exceed 99.5 % of the frequencies of all other taxonomic composites.

The dominant school of thought is accounting theory and the dominant accounting area is financial. While foundation discipline and mode of reasoning are diverse, it should be noted that the research method in all but one of these composites is internal logic. This implies that most research in this period did not rely on gathering and analyzing data but on argumentation, whether by verbal discourse or by mathematical modeling.

The next two tables display those taxonomic composites which made up the 99.5th percentile of papers in all journals from 1974 to 1983, and 1984 to 1993 respectively.

TABLE 7

Top Taxonomic Combinations All Journals, 1974 to 1983

all journals ('74 to '83)	school of thought	foundation discipline	research method	mode of reasoning	accounting area
36 of 686	EMH	economics and finance	archival primary	regression	financial
14 of 686	accounting theory	accounting	internal logic	analytical	financial
14 of 686	accounting theory	accounting	internal logic	qualitative	financial
12 of 686	EMH	accounting	archival primary	regression	financial
10 of 686	other behavioral	psychology	laboratory	ANOVA	managerial
10 of 686	EMH	economics and finance	archival primary		financial
9 of 686	HIPS	psychology	laboratory	ANOVA	managerial
9 of 686	EMH	economics and finance	archival primary	ANOVA	financial
9 of 686	other	math	internal logic	analytical	managerial
9 of 686	accounting theory	economics and finance	internal logic	analytical	financial

In both tables, two new schools of thought emerge – EMH and HIPS. Furthermore, the dominant research methods now include primary archival and laboratory studies which are often paired with regression analysis and ANOVA as modes of

TABLE 8

Top Taxonomic Combinations All Journals, 1985 to 1995

all journals ('84 to '93)	school of thought	foundation discipline	research method	mode of reasoning	accounting area
72 of 932	EMH	accounting	archival primary	regression	financial
57 of 932	EMH	economics and finance	archival primary	regression	financial
28 of 932	information economics	accounting	internal logic	analytical	managerial
21 of 932	HIPS	psychology	laboratory	ANOVA	audit
15 of 932	other	accounting	archival primary	regression	audit
14 of 932	HIPS	accounting	laboratory	ANOVA	audit
14 of 932	information economics	economics and finance	internal logic	analytical	managerial
14 of 932	other	accounting	archival primary	regression	financial

reasoning. While other types of papers exist during this period, two specific types emerge as becoming dominant – (1) papers exploring EMH, using primary archival sources and regression statistics, and (2) papers studying HIPS, using laboratory methods and ANOVA.

The next table demonstrates the dominant taxonomic combinations in all journals for 1994 to 2003. In this time period,

TABLE 9

Top Taxonomic Combinations All Journals, 1994 to 2003

all journals ('94 to '03)	school of thought	foundation discipline	research method	mode of reasoning	accounting area
79 of 940	EMH	economics and finance	archival primary	regression	financial
44 of 940	EMH	accounting	archival primary	regression	financial
30 of 940	EMH	accounting	archival secondary	regression	financial
19 of 940	HIPS	psychology	laboratory	ANOVA	audit
16 of 940	other	accounting	archival primary	regression	financial
15 of 940	information economics	economics and finance	internal logic	analytical	managerial
15 of 940	accounting theory	accounting	archival secondary	regression	financial

the two types of papers identified earlier have become completely dominant.

The next three tables drill-down into the population and explore the changes in dominant taxonomic combinations by journal. As in the previous tables, the data are divided into the same four time periods.

TABLE 10

Top Taxonomic Combinations, CAR

CAR	school of thought	foundation discipline	research method	mode of reasoning	accounting area
'84 to '93					
15 of 230	EMH	accounting	archival primary	regression	financial
13 of 230	information economics	economics and finance	internal logic	analytical	managerial
'94 to '03					
19 of 288	EMH	economics and finance	archival primary	regression	financial

Because CAR began publication in 1984, there are no taxonomic combinations identified in the 1963 to 1973 and 1974 to 1983 periods. In the two later periods, consistent with the trend in all journals, CAR began to develop research characterized by a focus on EMH, using archival data sources and regression statistics, contributing to financial accounting.

Table 11 shows that JAR exhibits a similar trend towards research that is focused on capital markets and driven by archival data and regression analysis. However, it also shows an emphasis on HIPS, information economics, and information technology during the 1974-1983 and 1984-1993 periods.

Finally, the changes in taxonomic composite types in TAR papers are summarized in the table below. Once again, the table reveals a migration from research focused on accounting theory and using qualitative methods to research in EMH, using regression analysis of archival information.

While all three journals seem to follow the same trend to market research and to empirical and quantitative methods, some differences become apparent. For example, CAR does not seem to have emphasized HIPS research in any of the time periods under consideration as it was in TAR and JAR.

In summary, the cross-sectional and longitudinal analyses of composite taxonomic profiles reveals that historically, the topical focus of accounting was on accounting theory, and the

TABLE 11

Top Taxonomic Combinations, JAR

JAR	school of thought	foundation discipline	research method	mode of reasoning	accounting area
1963 to 1973					
21 of 269	accounting theory	accounting	internal logic	qualitative	financial
9 of 269	EMH	economics and finance	archival primary	regression	financial
8 of 269	math programming	allied mathematics	internal logic	analytical	managerial
'74 to '83					
22 of 317	EMH	economics and finance	archival primary	regression	financial
7 of 317	other behavioral	psychology	laboratory	ANOVA	managerial
7 of 317	EMH	economics and finance	archival primary	nonpara-metric statistics	financial
6 of 317	HIPS	psychology	laboratory	ANOVA	managerial
'84 to '93					
33 of 304	EMH	economics and finance	archival primary	regression	financial
28 of 304	EMH	accounting	archival primary	regression	financial
8 of 304	information technology	math	internal logic	analytical	managerial
8 of 304	information economics	accounting	internal logic	analytical	managerial
8 of 304	information economics	accounting	internal logic	analytical	audit
'94 to '03					
31 of 317	EMH	economics and finance	archival primary	regression	financial
14 of 317	EMH	accounting	archival secondary	regression	financial
12 of 317	EMH	accounting	archival primary	regression	financial

methodology was non-empirical and qualitative. However, in later years, the focus shifted to capital markets, with an emphasis on archival sources and regression analysis. Research on human behavior has also become prevalent.

Nevertheless, the earlier non-empirical, qualitative research on accounting theory still comprised the majority of research from 1963 to 2003. However, as empirical, quantitative, market-

TABLE 12
Top Taxonomic Combinations, TAR

TAR	school of thought	foundation discipline	research method	mode of reasoning	accounting area
1963 to 1973					
157 of 669	accounting theory	accounting	internal logic	qualitative	financial
15 of 669	accounting theory	economics and finance	internal logic	qualitative	financial
14 of 669	math programming	allied mathematics	internal logic	analytical	managerial
14 of 669	accounting theory	accounting	internal logic	qualitative	mixed
’74 to ’83					
14 of 369	EMH	economics and finance	archival primary	regression	financial
12 of 369	accounting theory	accounting	internal logic	qualitative	financial
10 of 369	accounting theory	accounting	internal logic	analytical	financial
9 of 369	accounting theory	economics and finance	internal logic	analytical	financial
’84 to ’93					
29 of 398	EMH	accounting	archival primary	regression	financial
21 of 398	EMH	economics and finance	archival primary	regression	financial
9 of 398	HIPS	psychology	laboratory	ANOVA	audit
9 of 398	EMH	accounting	archival primary	descriptive statistics	financial
7 of 398	HIPS	accounting	laboratory	ANOVA	audit
7 of 398	information economics	accounting	internal logic	analytical	managerial
’94 to ’03					
29 of 335	EMH	economics and finance	archival primary	regression	financial
24 of 335	EMH	accounting	archival primary	regression	financial
10 of 335	other	accounting	archival primary	regression	financial
9 of 335	EMH	accounting	archival secondary	regression	financial
8 of 335	HIPS	psychology	laboratory	ANOVA	audit
8 of 335	information economics	economics and finance	internal logic	analytical	managerial

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oriented research continues to generate more publications, this dominance is likely to be erased.

METHODS FOR GATHERING AND ANALYZING DATA FOR CITATION ANALYSIS

Gathering Citation Data: Citation analysis is basically concerned with determining which other research a paper has referenced. Thus, the bibliographies of each of the papers published in the three selected journals in the years 1998 to 2003 were examined to determine which other papers had been cited. Counts were made of the number of times a paper in one of the three journals cited a paper appearing in any of the three journals, including cases wherein a paper cited another paper in the same journal (self-citations).

Citation Metrics: Based on the above counts, citation metrics were used to summarize the data. The citation metrics used in this research were adapted from Eagly [1975] and Borokhovich *et al*. [1995]. These citation metrics include the send-receive ratio and the journal-impact factor, both evaluative citation metrics, and the self-feed ratio, a descriptive citation metric.

Eagly [1975, p. 880] defines the send-receive ratio as:

> the ratio of the number or proportion of messages sent (the frequency with which the journal is cited by other journals) to the number or proportion of messages received (the frequency the journal cites other journals). High values (approaching or exceeding 1) of the send-receive ratio suggest that the journal is a feeder of network information, while lower values (approaching 0) suggest that the journal is a storer of network information. The high values may perhaps be interpreted as indicative of the journal's innovative role as a well-spring of seminal ideas in the discipline as well as an index of the journal's relative prestige.

The send-receive ratio is calculated by the number of times that any individual journal is cited by other journals, divided by the number of times that journal cites other journals. The resulting quotient is thus a comparison of the journal's influence on other publications, relative to their influence on it. This quotient is therefore increasing in the relative influence of the journal within a research network.

Another evaluative citation metric is the journal-impact factor. Borokhovich *et al*. [1999] used impact factors as an objective

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quantitative measure to determine the leading finance journal while Borokhovich *et al*. [1995] deployed impact factors to determine faculty scholarly productivity.

The journal-impact factor is computed as the number of times in a particular year that a journal is cited by other journals, divided by the number of papers published in that journal in the preceding two years. Hence, the resulting quotient is an indication of the extent to which the volume of research a journal has published has generated an impact within the research network. The numerator would be proportionately greater than the denominator for journals whose influence and prestige are more recognized because those journals would be cited very frequently, even if the body of work from which those citations are derived is small. The choice of the number of the preceding two years' papers as a denominator makes the ratio a measure of the recent standing of the journal among citing scholars. It must be noted that the denominator excludes the number of current-year publications because it would probably be too soon to expect these papers to generate a significant amount of citations.

The self-feed ratio, on the other hand, is a descriptive citation metric. It is the propensity of a journal to cite itself and is used in this research as a measure of research integration. The self-feed ratio is calculated as the number of times a journal cites itself, divided by the number of times it cites other journals. Thus, the resulting ratio indicates the proportion at which the information cited by a journal originates from the research published in the journal itself. As discussed later, while this metric is often viewed as a measure of the degree of specialization of a journal, it also is an important indicator of the ability of a journal to assimilate, discuss, and refine its own findings, thereby increasing their validity and significance.

Results of Citation Analysis: The annual number of external citations, published papers, and self-citations of each of the three journals was determined. Based on these counts, citation metrics were computed for each year and the annual counts averaged for each journal.

JAR was revealed to have the highest values for both evaluative citation metrics (send-receive ratio and journal-impact factor). TAR had the second highest impact factor, while CAR had the second highest send-receive ratio. The descriptive citation metric, the self-feed ratio, reveals that CAR authors as a group cite themselves the most, followed by TAR and JAR in that order.

TABLE 13

Citation Analysis Results

Average:	CAR	JAR	TAR
Send-Receive ratio	1.19	3.02	0.86
Journal-Impact ratio	1.93	5.20	4.75
Self-feed ratio	0.23	0.12	0.13

Methodology for Gini Metric and Taxonomic Diversity Analysis: The diversity of the research (in the three journals) is determined by the Gini metric computed over the fractions of papers classified under each of the various classifications in four selected taxonomic categories, the two topical taxons (school of thought and foundation discipline), and the two methodological taxons (research method and mode of reasoning). This is done by summing the squares of the proportions of papers falling under each taxonomic category out of the total number of papers in a journal [Stigler, 1994]. This results in a metric that is closer to zero if it is more diverse and closer to one hundred if it is more concentrated, although some researchers will use an alternative formula of one minus the sum of the squared proportions in order to yield a metric that increases in diversity [Badua, 2008].

Results of Taxonomic Diversity Analysis: JAR and TAR proved to have almost equally diverse arrays of research methods as borne out by their low Gini metric for this taxon (25.45 and 25.93 respectively). CAR proved to be less diverse with a resulting Gini metric of 36.62 for research method.

TAR was the journal with the most diverse set of data-analysis tools with a Gini metric for mode of reasoning of 17.24. Once more, JAR authors' choice of modes of reasoning was only slightly less diverse, resulting in a Gini value of 17.57. CAR's Gini score was the highest at 20.42, indicating that this journal had the smallest and most narrow selection of modes of reasoning among the three journals.

Once again, TAR and JAR authors seemed to have the more diverse topical interests, with CAR articles reflecting less variety in topical foci. TAR's Gini score computed for school of thought (12.75) was slightly lower than JAR authors (12.92), but both were much lower than CAR's (17.64). This indicates that TAR and JAR focused on a broad array of accounting research topics while CAR was more selective.

Furthermore, TAR and JAR drew from more varied sets of foundation disciplines than did CAR. This was proven by their lower Gini scores computed for foundation discipline (25.58 for TAR, 25.72 for JAR, compared to CAR's 34.20).

Overall, JAR and TAR had an average Gini score of about 20 for all four taxons under consideration, meaning that they were about as diverse as one another methodologically and topically. CAR, with an average Gini score of 27 computed over all four taxons, proved to be less diverse.

Table 14

Taxonomic Diversity Results

Gini	**CAR**	**JAR**	**TAR**
Research Method	36.62	25.45	25.93
Mode of Reasoning	20.42	17.57	17.24
School of Thought	17.64	12.92	12.75
Foundation Discipline	34.20	25.72	25.58
Average	27.22	20.41	20.37

CONCLUSIONS AND IMPLICATIONS

Content of Accounting Research: This paper reports the results of a study of mainstream accounting literature over time as an exercise in the study of the development of accounting thought. As such, it has been an effort to analyze and characterize the content and evolution of accounting research. By this characterization, the paper seeks to provide a conception of accounting research over time based on the efforts of those who produce, use, and evaluate it.

The taxonomic analysis reveals that mainstream accounting research is characterized by significant differences in topical emphases and methodological tools. While it has historically been devoted to qualitative studies on accounting theory, this research has evolved to focus on economics and finance using quantitative analysis of archival data. This is consistent with previous research that has documented the strong capital markets and econometrics orientation of accounting research in general. An emphasis on behavioral topics, whether viewed from the prism of information economics or psychology, has also developed.

The findings also suggest differences in the content and evolution of the journals studied. For example, JAR and TAR seem to have embraced behavioral research to a much greater degree than CAR. Differences also exist among the journals not only in the predominant methods used and topics studied, but also in the diversity of methodologies and topical foci.

Communication and Quality of Accounting Research: In the past, citation metrics could provide only proxy measures of research quality. This is because whereas the frequency that a piece of research is cited, or the number of other research artifacts referencing the cited research indicates the perception of quality that the citing scholars have for the work, it does not capture the specific characteristics that contribute to that positive perception.

Indeed, although they are in the minority, some citations may not actually reflect a positive opinion of the cited research (as is normally the case when a researcher consults the cited work for corroboration or inspiration). This is so when research is cited for the purpose of critique or contradiction. In either instance, the reference appears as a cited item in the bibliography.

Future Research and Recent Developments: Some of the analyses developed in this paper suggest it would be theoretically possible to construct an alternative measure of research quality, one that takes into account the content of the research rather than merely relying on measures of reader perception to proxy for quality. This measure of research quality would consist of a measure of the diversity of a journal's methods and topics and a measure of the extent to which the journal has integrated its findings. Topical and methodological diversity are both important and desirable characteristics as a research outlet that studies a variety of topics and uses multiple methods to prove and corroborate its findings contributes (a) information on a wide variety of issues which is (b) highly likely to be valid, due to triangulation by multiple modes of data gathering and analysis [Robey, 1996; Lewis 1999]. Thus, research is best advanced by a journal that is both topically and methodologically diverse.

Paradoxically, diversity may also be a bad symptom. If a research paradigm is too diverse, it may be a sign of dissent among its scholars and the start of the decay and fragmentation of whatever research paradigm to which these scholars subscribe. This phenomenon is known as incommensurability. That is, "there are no common measures among diverse paradigms of inquiry, so that representatives of different paradigms live in different worlds, hold mutually exclusive beliefs, and use different vocabularies" to the extent that there is no "meaningful communication" and researchers "risk self-stultification" [Weaver and Gioia, 1994, p. 565]. Thus, researchers who study vastly different topics and/or use radically different methods to study these topics will tend not to communicate, and when there is no active dialogue between constituent scholars, their findings will not benefit from the refinement and validation that communication and collaboration provide.

Therefore, research quality would be expressed as a metric comprised of the interaction of two things: (1) some measure of diversity and (2) some measure of dialogue within a journal. A number of the metrics computed in this paper, such as the Gini and self-citation metrics, could possibly be adapted to the task. In order to determine the validity of this measure, it could be correlated or regressed against other accepted proxies of research quality; for example, the evaluative citation metrics used in this paper. Because this paper only has six years (1998 to 2003) of citation data, such an analysis would have limited statistical validity even if significant results were found. Thus, we leave the final operationalization, implementation, and validation of the metric for future research. With theoretical refinements and additional data, the metric might indeed prove to be a direct means of measuring research quality.

While such a method permits a quality determination that is more direct than traditional citation-based metrics, there are limitations and qualifications which apply. Academic organizations such as the Association for the Advancement of Collegiate Schools of Business (AACSB) and the American Accounting Association (AAA) have recently asserted the need for demonstrating research impact on industry as an essential component of research quality or value. The implication of these recently announced initiatives are manifold [AACSB, 2008]. Is it sufficient to consider and classify research by such measures as citations, when this metric is decidedly biased in terms of measuring work which is "by academics for academics?" In an applied discipline such as accounting, are impact measures not better developed by demonstrations of "real world impact," and, if so, what measures should be used [AAA, 2009]?

Our paper therefore, while limited in this "real world" element, opens the way for others to study the development of accounting thought over time with a view toward alternative measures of quality and impact. Also, we recognize the nascent character of quantitative metrics as developed herein and encourage continued future research into the development of our literature with expanding attention to developing the means to improve our understanding of the qualitative and impact factors of our discipline's thought over time without merely relying on indirect proxies such as citation metrics.

Thus, this paper concludes with the idea that research quality may be measured in many ways. However, it may be determined by its content and how it has been communicated. As in human conversations, the quality of the colloquy among accounting researchers depends on the variety of topics discussed, the different ways by which assertions are validated, and the degree to which one meditates upon one's beliefs before sharing them with the world.

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THE FIRST EXTERNAL AUDITORS OF THE HUDSON'S BAY COMPANY, 1866

Abstract: At the request of shareholders, the Hudson's Bay Company had its financial statements audited for the first time in 1866. Two external auditors were hired, one for the shareholders and one for management. Three inter-related forces led to this decision: (1) most importantly, the company's shareholders demanded audited financial statements, (2) there was emerging in London at the time the capacity and willingness among London accountants to provide external audit services, and (3) the British Parliament passed various acts that required financial statements of companies in other industries to be audited. After a few years, only the management's external auditor was retained. He subsequently influenced the company's development of management accounting. In addition, the company's early external auditors were influential in the development of the Institute of Chartered Accountants of England and Wales.

INTRODUCTION

The Hudson's Bay Company (HBC) is the world's longest surviving commercial organization that continues in its original line of business [Milgrom and Roberts, 1992, p. 9]. It was a successful, London-based, joint-stock company for 300 years before it became a Canadian public company in 1970. In recent decades, the HBC became less competitive, and in 2005, it was acquired and subsequently converted into a private company.

In its 341 years, the HBC has experienced many accounting and auditing changes. The HBC's management accounting changes have been discussed by Spraakman and his co-authors.[1] That research traced the management accounting practices of the HBC from 1670 to 2005 and found that the company had four different management accounting programs with the fifth

[1] See references for relevant HBC articles by Spraakman and his co-authors [Spraakman and Davidson, 1998; Spraakman, 1999, 2002, 2010; Spraakman and Margret, 2005a, b; Spraakman and Wilkie, 2005.

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in the initial phase in 2005. The overall conclusion was that management accounting was slow to change, but when it did, the justifications and changes were significant. This research noted briefly that the HBC's first external auditor appointments had been made in 1866.

Despite its richness in terms of longevity and comprehensiveness, the HBC's archives have not been used to examine in depth the beginnings and development of its external auditing. The archive of no other commercial company in the world contains so many years of accounting documents. E.E. Rich [1958, p. xi], HBC scholar and Cambridge University professor, observes that the company "preserved a unique and magnificently full series of documents which take the story back even to before the Charter of 2nd May, 1670, and with great cost and sense of purpose it has assembled its archives, sorted and catalogued them, and prepared them for the use of the historian."

Short shrift to auditing is common as Matthews [2006, p. 2] concludes "that there has been very limited primary research into the history of the audit on either side of the Atlantic." This paper will address in part this shortcoming by documenting the first external auditors at the HBC. It demonstrates how the external auditors and their audits changed the way in which accounting was done. In addition, this paper will document the affiliation of the HBC's earliest external auditors to the development of professional external auditing in London as well as within the Institute of Chartered Accountants of England and Wales (ICAEW).

The context and environment surrounding the introduction of external auditing in 1866 will be revealed in the next section, followed by section three which describes the conditions accompanying the introduction of the HBC's first external auditors. There were two external auditors, one for the shareholders and the other for the governor and committee (comparable to the contemporary board of directors). Section four documents the evolution of the auditor's external audit activities for several decades at the HBC, while the next explores his management advisory activities. The last section is a discussion of findings and conclusions.

CONTEXTUALIZATION

The decision to hire external auditors can best be appreciated by understanding the context. More specifically, in 1860, the HBC's longest serving governor, George Simpson, died. For the previous 40 years, he had run the company's fur trade business successfully in his inimitable way. The HBC had achieved much during those years. Due largely to its success especially during the Simpson years, economists have evaluated the HBC to be one of the few companies in the world to have earned an economic rent from its unique resources. It appears to have been singularly successful [Schoemaker, 1990, p. 1,180] as were IBM and Proctor & Gamble at later points in time.

Added to the loss of Simpson's strong leadership, the HBC faced four external but related shocks during the last 40 years of the 19th century. First**,** modernization changed the way in which the HBC conducted its fur trade business. Canoes and boats on lakes and rivers were no longer the means for communications and transportation. The first significant challenge to the value of the HBC's communications and transportation system came in 1859 from the introduction of steamboats [Innis, 1956, p. 344]. Transportation costs were further reduced with the extension of the Northern Pacific Railway, which was completed to Winnipeg by the Canadian Pacific Railway (CPR) in 1878. The CPR, however, had a much greater impact on lowering costs when the trans-Canada line was completed in 1885. The rail was not only cheaper than canoes, York boats, and steamboats, but it was also quicker and more reliable [Barris, 1977, p. 41].

Similarly, modernization enabled barter in North America to be gradually replaced by cash transactions.[2] Previously, the HBC had to create a trade currency, which it did by equating all furs and trade goods to a prime beaver pelt, called a "made beaver." This "made beaver" system was a means of influencing the lives of the aborigines; trapping and the consumptions of European goods became a more significant part of their lives [Neu and Therrien, 2003, pp. 27-28]. The "made beaver" system worked well from 1670 to the last half of the 19th century when modernization gradually demanded that it be replaced with cash transactions. The conversion from "made beaver" to cash changed how the aborigines dealt with the HBC. Unlike barter, they did not have to conduct both transactions – the sale of furs and the acquisition of trade goods – with the HBC.

The isolation of the fur posts and employees decreased in relative terms after 1860 with communications and transportation developments. Correspondence and travelling times were also reduced significantly. With the telegraph that accompanied

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[2] The paper will refer to "North America" as the location of the HBC's operations prior to Canadian Confederation (1867) and "Canada" thereafter.

modernization, instructions could be detailed and given frequently to the traders along with advice on the latest market prices in London.

Second, the company was required to give up its charter that had been received from the King of England in 1670. The HBC, in 1870, turned its trade monopoly, charter, and lands over to the Canadian government for remuneration (£300,000). One important term in the transfer was that the HBC received a 1/20th share of prairie-parkland real estate in what became Western Canada, thereby entering the land business.

Third, in 1868, the concerns over the future (e.g., loss of charter, modernization, and consequences on business) encouraged the governor and committee to hire an external consultant, Cyril Graham. He was a vice-president at the Transatlantic Cable Company and had been in the British Colonial Office. Thus, Graham had both business and governmental credentials. The governor and committee followed Graham's recommendations, which included pursuing modernization as the most significant. With the steam ships on rivers and lakes and later the railway, the HBC largely replaced its own communications and transportation system by contracting with suppliers. At the same time, the company got out of the business of supplying food and clothing to its employees by relying upon an emerging infrastructure. Hence, the company shrank and with improvements in communications and transportation, it became easier to manage. Consequently, the HBC was able to change its fur-trade organizational structure by eliminating a level of management. Prior to the forces of modernization, there were four levels in the fur-trade business: posts, districts, departments, and the commissioner (the new title for inland governor). Departments were eliminated and subsequently district managers reported directly to the fur-trade commissioner, thus increasing the number of managers directly reporting.

Fourth, the International Financial Society (IFS) acquired the HBC shares from its existing shareholders in 1863 and sold those shares at a premium to new shareholders who expected more from the company. The IFS had an effect on how the HBC was managed. The new owners became increasingly demanding [Mitchell, 1953, pp. 220, 241; Ray, 1986, p. 5]. The HBC also followed the advice of Graham when it entered the retail business with saleshops in 1871. Thus, the company had three businesses-fur trade, land, and saleshops. In this context, this paper will examine how the company came to hire its first external auditors.

EXTERNAL AUDITORS AND AUDITING

The HBC's first external takeover was initiated in 1863 by the English promoter Edward Watkin, who at the time was a member of the British Parliament [Hodgkins, 1999, p. 2]. He was familiar with both Canada and the HBC. In 1861, he went on a mission to Canada at the request of the British government to investigate the possible confederation of five British provinces into the dominion of Canada and transferring the HBC lands to the new Canadian government [Sutton, 2004]. At this time, there was a group of businessmen and British government officials interested in building a telegraph line to the Pacific and a related group who wanted to expand the Grand Trunk Railway into an inter-colonial railway connecting Nova Scotia through Upper Canada (now Ontario) to the Pacific Ocean [Mitchell, 1953, pp. 222-227]. He also informally represented some of the owners of the Grand Trunk Railway.

An obstacle to the plans for the inter-colonial railway and the telegraph was the HBC. The company was not willing to cooperate with either plan. Instead the governor and committee wanted the company to be purchased for £1.5 million. The IFS was an investment group formed by Watkin and some of his investor friends willing to put up their personal money to acquire the company's shares from the existing owners for £1.5 million, about 50% over the market price [Mitchell, 1953, pp. 241-242]. None of the members of the IFS had a dominant share position. With promotion of the HBC's untapped potential from future settlement, the IFS sold the shares for approximately £2 million. None of the buyers had dominant share positions at the time at this transaction. Watkin and his fellow investors benefited handsomely. After replacing existing shareholders (except for two), the IFS disappeared.

The HBC was not removed as an obstacle by the purchase of 1863, but the new owners were more cooperative [Mitchell, 1953, p. 220]. The groups representing the interests of the Grand Trunk Railway and the proposed telegraph to the Pacific Ocean were not represented by the new owners of the HBC.

The hiring of external auditors was initiated on November 28, 1865 at the general court by a Mr. R.A. Heath, who made a motion which was carried unanimously [HBC, annual report, 1865]. Heath was a proprietor or shareholder but not a committee (board) member. The minutes of the general courts suggest that shareholders were active in questioning the governor and committee about financial prospects [HBC, annual

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reports, 1866-1900]. Active shareholders at this time were not as described by Maltby [1999, p. 38], who found that "investors tended to rely on personal acquaintances and experience rather than on accounting data." The HBC's financial statements were audited for the first time and signed by the external auditors in 1866 [HBC, annual report, 1866].

It is important to understand the specific business environment in London at the time Mr. Heath made the motion for appointing external auditors. The Joint Stock Companies Act of 1844 made incorporation easy and inexpensive [Boyns *et al.*, 2000, p. 97]. It required that a balance sheet be presented to the shareholders at the annual general meeting and a copy of the balance sheet had to be filed with the Registrar of Joint Stock Companies. Auditors could be appointed; directors of the company could be selected as the auditors. Then the Joint Stock Companies Act of 1856 cancelled the requirements under the 1844 Act for the presentation of a balance sheet to the shareholders at the annual general meeting. The 1856 act included a model set of Articles of Association for preparing the balance sheet and profit-and-loss statement for an audit [Maltby, 1999, p. 33].

The Companies Act of 1862 consolidated various acts to become the principal act without changing the voluntary requirements. However, it was not until the Companies Act of 1900 that compulsory external audits were reintroduced for all limited British companies [Edwards and Webb, 1985, p. 179; Chandler and Edwards, 1996, p. 8]. The act defined an appointment method and remuneration for auditors, their rights of investigation, and their general duties. Only then were directors and officers of the company ineligible to act as external auditors. In the half century prior to the 1900 act, there were no requirements for the auditor to hold a professional qualification [Maltby, 1999, p. 38]. It was frequently stipulated in a company's articles that the external auditor should be a shareholder.

During the 40 year period prior to 1900, there was a steady increase in the external audit of British companies, attributable to regulations. The HBC is significant to study as unlike many firms that introduced external audit at the same time, it was not regulated or required to produce audited financial statements. The shareholders demanded audited financial statements. Moreover, the governor and committee were willing to accept the inherent risk of a "special" or unique fur-trade accounting system that could be misunderstood [HBC, annual report, 1866].

Maltby [1999, p. 41] concluded that the requirement for external audits was likely facilitated by the gradual development of the accounting principles. She said:

> The late [19th] century saw the elaboration of accounting principles by the profession, in the pages of *The Accountant*, in textbooks written by Francis Pixley, Lawrence Dicksee and others, and in the lectures and papers read to students' societies. The principles developed gave a key role to *prudence;* current assets should be valued at the lower of cost and realizable value, fixed assets should be depreciated, irrespective of their market value, and provision should be made for losses as soon as they appeared possible.

The principles became the base against which the auditors assessed a company's financial statements.

Chandler and Edwards [1996, p. 7] claimed that 1900 was the beginning of a "golden age" for external auditors. They articulated a definite position among the new professions (e.g., engineering, architecture), and there was for the first time general understanding of the "nature and limitations" of external audits. Nevertheless, professionally qualified auditors were not required by the Companies Act until 1947 [Edwards, 1989, p. 209]. The HBC's decision to engage external auditors came 35 years before required by law. The shareholders, who unanimously approved the motion to engage external auditors, were aware of the advantages of external auditors.

For the nearly 200 years prior to the IFS, the HBC's financial statements did not appear in the minutes to the semi-annual general courts. The first financial statements appeared in the minutes for 1864 [HBCA,2.3.84]. Prior to 1864, there was no evidence in the minutes about the inclusion of copies of the financial statements although there was discussion in the general courts about the financial condition of the company when the governors announced the payment of dividends. Apparently, the "grand ledgers" were placed on the "table" for shareholder viewing. The HBC broke with this tradition by publishing its audited financial statements in 1866. Comparable publication was introduced for railways in 1868, life assurance companies in 1870, the gas industry and waterworks in 1871, building societies in 1874, and the electricity industry in 1882 [Maltby, 1999, p. 33].

The first audit report is recorded below verbatim [HBC, annual report, 1866].

REPORT OF THE AUDITORS

To the Governor and committee of the Hudson's Bay

Company

Under and in accordance with the following resolution of the proprietors of the HBC:

That a professional auditor be appointed by the governor and committee, and that Mr. Watkin be appointed shareholder auditor.

That the two auditors report to the shareholders at the next general meeting as to the state of the accounts of the company.

We have audited the accounts of the company for the year ended May 31, 1866, and have made out and signed an account which is attached hereto in accordance and conformity with the Deed Poll.

We would, however, draw your attention to the fact that the stock of goods and stores has been increased by £71,991 14s.11d., which sum includes the usual addition of 33 percent on the cost price, equal to £17,997 18s.9d., to cover freight and charges, it being understood that such freight and charges do not, in practice amount to so much as 33 percent: therefore, this credit contains an amount of assumed and unrealized profit, and it is for the governor and committee to consider how far such a profit can be now divided amongst proprietors.

Again: the following charges for interest, viz.: North West Telegraph, £8,41 2s. 5d., Puget Sound Company, £1,246 8s.3d., James Douglas, £145 8s.10d., are credited to the interest account, and although it is quite true such charges have accrued due and may ultimately be recovered, still, their amount has not yet been received, so that the above remark is equally applicable to these items.

The amount standing to the debit of the account of the purchase of Governor Douglas's interest as a trader being to a considerable extent irrecoverable, should be written off in these or in the next accounts.

As regards the bills held as security for the amounts placed in deposit with Overend, Gurney and Company, we accept the assurance of the secretary that the governor and committee are satisfied that these deposits will be fully repaid, a conclusion in which, from an inspection of the bills themselves, we quite concur, although some delay may arise in the realization.

> Referring to the capital account we observe that the item of £1,073,192 16s. 2d for territory, rights and fixed property, can only be taken as a balancing item dependent, first, upon the cost and value of the forts, stations, cultivated farms and other property valuable and necessary for the conduct of the trade, and which, paid for from time to time mainly out of revenue, have no doubt cost a very large sum, not specially debited from time to time; and, secondly, upon the future realization of wild lands, and of mines, fisheries and other rights and royalties over the vast area comprised in the company's possessions: it clearly would be impossible to define the latter and it might even under present circumstances be highly inexpedient; but it is not impossible to make a reliable estimate in detail of the former, and to record the result in the books as a separate and special item of capital, liable to annual addition or deduction. We recommend this subject to your consideration.
>
> We have received every assistance from Mr. Roberts, your valued accountant, in conducting the audit, and although the books of the company exhibit a special system, they are very regularly and carefully kept.
>
> Edw. W. Watkin William Quilter
> Auditors
>
> London, June 19, 1866.

Watkin and Quilter prepared the 1866 financial statements, consisting of the balance sheet, profit-and-loss statement, and general account (which exhibited the profit-and-loss results for the outfit of the previous year), and then audited them. This is divulged in the fourth paragraph, i.e., "we have made out and signed an account." In 1866, when Watkin and Quilter signed the HBC's financial statements, external auditors tended to prepare the financial statements and audited them. Further support comes from the observations during the time period that companies failed to distinguish between accounting and audit fees [Matthews, 2006, pp. 12, 16].

> If today 'auditing can be viewed as the checking of the work of one set of skilled financial accountants by another' [Sherer and Kent, 1983, p. 17] this has only relatively recently become the case....The professional audit in Britain then was from the start closely bound up with bookkeeping and…this accountancy role often preceded that of auditor. From the 1860s, accountants... had to put the client's accounts in order, and when they

> subsequently assumed the role of auditor as a matter of course they continued responsibility for the accounts …At least down to the 1960s, the majority of British 'audits' were therefore something of a polite fiction and not pure audits which the articled clerks were taught in their textbooks…Accounting firms…were frequently asked to finish the balance sheet and take out the balance and write up the book.

The financial statements of 1866-1868 appeared to have been prepared and audited by the external auditors. The two auditors claimed to have "made out and signed an account." In contrast, the financial statements in 1869 and thereafter were not prepared by the external auditor. He only audited them. More specifically, in his 1869 audit report, he averred that he had "examined and found to be in due accordance with the Books, Accounts, and Vouchers of the Company" [HBC, annual report, 1869]. There was no admission that the auditor prepared the financial statements. Also, there was only one external auditor by that time, Quilter, who had been the external auditor for management, (i.e., governor and committee). It should be noted that in 1869, Quilter did a detailed audit to the voucher level.

There is further evidence that the external auditor examined the financial statements and books but did not prepare the financial statements. This evidence came from the governor at a general court. Specifically, in response to a question from a shareholder about the external auditor's fees, Governor Sir Stafford Northcote said of the external auditor:

> Mr. Quilter [the external auditor], with the assistance of two of his clerks, has been a very considerable time in the examination of the company's books, that all the books are laid open before him, and not only so, but it has frequently happened, since I have been connected with the company, that we have had meetings with Mr. Quilter, and discussed with him for perhaps more than one day at a time – or rather, for more than one sitting – the mode in which certain accounts ought to be presented – what should be reckoned as profit, what should be reckoned as due to capital, and so forth; and I should certainly think the company would behave very unwisely if they were to dispense with the services of a first-class auditor for such purposes.

Note, the governor specified that the external auditor examined the books that were made available to him. These appeared to be discussions between the governor and the external auditor on presentation and classification matters. Moreover, there were no indications on the financial statements that the external auditor prepared the financial statements in 1869 and in subsequent years.

Matthews [2006, p. 7] and Edwards *et al*. [2007, p. 82] found that Quilter had been frequently requested "to sort out railway frauds and other financial problems, and…[was]… often responsible for putting…accounting systems on a sound footing." It was accountants such as Quilter who improved accounting practices among companies particularly when going public [Edwards, 1985, pp. 36-38; Matthews, 2006, p. 9]. He was also active in the Institute of Accountants of London (IAL), one of the five groups that would form the ICAEW. Walker [2004, p. 143] reported that on June 8, 1870, nine of the leading accountants in London gathered at the offices of Quilter's firm to consider establishing the IAL. In addition, Quilter chaired the meeting on November 29, 1870 that actually established the IAL. The ICAEW received its royal charter in 1880. Its formation was the result of the amalgamation of five public accounting groups, each of which had been formed in the 1870s [Walker, 2004, p. 127].

Matthews [2006, p. 7] found that after the aforementioned railway act of 1868, the financial statements of railway companies exceeded all other British companies in detail and accuracy. The railway companies had by that date established skilled accountants and routine accounting practices that made the recruitment of external auditors to prepare the financial statements unnecessary. Due to the quality of the financial statements, the external auditors were able to limit themselves to auditing the financial statements of railway companies. The fact that the HBC's financial statements were no longer prepared by the external auditors in 1869 attests to the ability of the HBC accountants and the quality of its financial statements. The railway companies and the HBC were more advanced in the accounting for financial statements than most other companies in Britain during the last quarter of the 19th century [Matthews, 2006, p. 8].

It was noted that Quilter continued as the external auditor, but Watkin, the shareholder external auditor, did not. Matthews [2006, p. 10] discussed the use of shareholder auditors in the second half of the 19th century:

> it…was an established practice in joint stock companies (like the old trading concerns such as the East India

> Company or the canals, gas and water works) for the shareholders, who took no part in running of the companies, to elect at their annual or bi-annual meetings one or two of their number to audit the accounts, and so keep an eye on their investments.

Matthews [2000, p. 11] labelled them "amateurs" and assessed their contribution to be "no more than a cursory inspection on the day of the general meeting." Consequently, he concluded that these amateurs quickly had themselves replaced by professional external auditors. For example, in 1883, all major British companies had amateur external auditors, but in 1900, nearly all had professional external auditors.

In addition, Edwards *et al*. [2007, p. 82] say that these shareholder auditors were motivated to ensure that the company's "resources…[were]…properly safeguarded and honestly managed." They concluded that these enthusiastic amateurs were unorganized and offered little defence against competition from professional external auditors. Consequently, they were easily replaced. There was no indication of any such tension at the HBC. However, this questions the need for both Watkin and Quilter with the audited financial statements in 1866-1868. Quilter would have been able to prepare and audit the financial statements himself. He was familiar with the accounting records as he had been employed by the HBC as an accountant or auditor from 1863 [Edwards, 2004], but there was no evidence that he prepared the previously mentioned first set of financial statements of 1864 as those statements were not signed by him. Rather, they were unsigned [HBCA. A.2.3.84]. They could have been prepared by or in conjunction with the chief accountant at the time, the highly lauded Edward Roberts, who had introduced numerous accounting system changes during his 1803-1870 career with the HBC [HBCA, A.10.35.129. A.64.38.16d]. Watkin did not have the credentials to prepare and/or audit the HBC's financial statements.

There has always been concern about the independence of the external auditor when reporting to management [Staubus, 2005, p. 5]. This may have tended to encourage shareholders to appoint their own external auditor. The question is, can the external auditor report honestly to shareholders about the performance of management when being paid by management? The existence of an external auditor for the shareholders attests to such questioning. At the same time, the managers wanted an external auditor reporting to them. Both the shareholders and the managers appeared to believe that the reporting relationship would affect the external auditor's reporting.

Maltby [1999, p. 46] has similarly argued that the audit profession in Britain has identified itself with management rather than shareholder interests. According to Maltby, it occurred because at the end of the 19th century, small investors were in the minority. The dominant form of governance continued to be the "insiders," who were prudent and tended to hold the shares for the long term. These investors were able to rely on private links with management.

EVOLUTION OF THE COMPANY'S AUDITOR

The 1865 motion specified that Mr. Watkin was the shareholders' external auditor. Mr. Quilter was the second external auditor and obviously the external auditor for the management (the governor and committee). Both auditors, listed in alphabetical order, signed each of the three financial statements for 1866. There were two external auditors for each year until the 1869 financial statements which were signed by only one external auditor, Quilter, described by the governor in the report to the shareholders as the "Company's Auditor" [HBC, annual reports, 1867-1869]. It should be noted that it was the company's external auditor that continued, not that of the shareholders.

Watkin and Quilter were eminent in their respective endeavors which overlapped with their railway activities. There was no indication of disharmony between the two external auditors. They likely knew each other before becoming the HBC's external auditors. Watkin had formed the IFS to acquire the shares of the HBC, and was thus well known to the HBC shareholders. He was still a member of the British Parliament. In 1845, he became secretary of the Trent Valley Railway, which was subsequently sold to the London and North Western Railway Company by which he was also employed [Sutton, 2004]. In 1853, he became the general manager of the Manchester, Sheffield, and Lincolnshire Railway. By 1865, he had become the chairman of the Manchester and Liverpool and the Grand Railways [Hodgkins, 1999, p. 2].

Quilter had also been active with railways as an auditor rather than as an investor [Edwards, 2004]. As an accounting expert, he was invited in 1849 to present evidence to a House of Lords select committee (Monteagle Committee) on the audit of railway accounts. The committee was established to investigate the "railway mania" of 1845. Quilter testified that (unnamed) railway companies were paying dividends out of capital rather than profits thus misrepresenting the financial situation [Bryer, 1991, pp. 456-457]. One aspect of Quilter's evidence was his stated opposition to any requirement that the auditors of railway companies be shareholders. Accordingly, he also believed that auditor ownership of shares compromised independence. He advocated the replacement of the shareholder auditors by professional auditors as was done by the HBC. Quilter became the sole external auditor for the HBC.

From 1869, the same auditor statement "examined and found to be in accordance with the Books, Accounts, and Vouchers of the Company," was used until 1892, when it was changed to [HBC, annual report, 1892]: "I have examined the books, accounts, and vouchers of the company in London, and the various authenticated statements and certificates received from Canada, and I hereby certify that the balance sheet and profit and loss accounts are in accordance therewith. Thomas A. Welton, Welton, Jones & co., 5, Moorgate Street, London, E.C."

Thomas Welton, from the same firm as Quilter [Matthews *et al.*, 1998, p. 26], became the HBC's external auditor in 1889 in succession to Quilter. Welton had also been active with the formation of the IAL [Walker, 2004, p. 143]. Subsequently in 1892, as president of the ICAEW, he lauded the "security we have taken, in the way of articles and examinations, for the proper training of the next generation of accountants" [Anderson *et al.*, 2005, pp. 22-23].

Governor Donald A. Smith noted at the 1892 general court that, "there is also appended to the statement of accounts the external auditor's certificate, more extended and more precise than in former years." The extended certificate noted that "various authenticated statements and certificates received from Canada" were included in the audit and the auditor's explicitly certified balance sheet and profit-and-loss accounts.

A major change came in the 1901 auditor's report, when Thomas Welton, the external auditor, specified [HBC, annual report, 1901]:

> In accordance with the provisions of the Companies' Act, 1900, I certify that all my requirements as Auditor have been complied with. I report to the Shareholders that I have audited the above Balance Sheet, and, in my opinion, such Balance Sheet is properly drawn up so as to exhibit a true and correct view of the state of the company's affairs as shown by the Books of the company in London, and the audited statements received from Canada.

In 1909, there was a slight change to the auditor's statement. Welton dropped "the Companies' Act, 1900" basis for the audit. He also referred to the accounting documents as "certified" rather than audited. The latter was a correction. Although external auditors were hired for the London financial statements from 1866, these external auditors did not travel to Canada to audit the accounting records. Welton, as well as the external auditors before him, depended on others to verify the HBC's Canadian accounting records. These records were not verified by the external auditors until 1912, as will be discussed later in the paper.

Chandler and Edwards [1996, p. 17] report on an 1890 survey by a senior partner on common certifications contained in external audit reports:

> The most common certifications included the succinct, if uninformative, 'Audited and certified,' 'Audited and found correct,' and simply 'Audited'…The clear implication being that the signature of a reputable accountant was sufficient to attest to the reliability of the accounts. Indeed, according to Pixley [an auditing textbook author], the last-named certification was the strongest the auditor could give as it implies that without a single reservation the accounts are correct in every particular…[The senior partner] favoured what would today be regarded as less primitive formats, including the following which anticipated fairly well the contents of the Companies Act 1900.
>
> We have examined the foregoing Balance Sheet with the books of the company, and in our opinion it is a full and fair Balance Sheet properly drawn up, so as shown by the books of the company…

The death of the external auditor, Mr. Thomas Welton, was announced at the July 18, 1918 general court. He was the company's third external auditor. Mr. Welton was replaced by Messrs. Deloitte, Plender, Griffiths & Co. They used similar wording with their first audit in 1919; the major difference was the use of "we" for the auditor rather than "I."

The London external auditors made their judgments on the company's financial statements which included documents prepared in Canada. The vast majority of the HBC's business had always been conducted there. As the external auditors were in London, there were requests for the verification or audit of an increasing number of recorded Canadian transactions. From about 1892 to 1911, the governor and committee, with the cooperation of the London external auditor and the commissioners (senior Canadian managers), hired "auditors" in Canada [HBCA. A.12.ft203.1.1-14]. The London external auditor provided instructions for the audits of the cash accounts and inventories primarily that were sent annually to the London accounting office. For example, in 1897, the London external auditor, Welton, wrote the following letter requesting the Winnipeg "auditor" (a Bank of Montreal manager) to verify the balance sheets, trading accounts, and profit-and-loss accounts [HBCA. A.12.203.1.13-14].

> Dear Sir,
>
> Audit at Winnipeg
>
> Referring to our conversation on 8th inst., I beg to say that I agree in thinking that efficiency in this case is more important than any small economy in the fee paid.
>
> The auditor seeks to check the voucher for each expended and agree the balance of cash monthly. I presume he also sees the books periodically (at least annually) and verifies a balance sheet, trading account and profit and loss account. The account current with the head office is doubtless referred to in this connection and any items not yet responded to are considered, as to the time having been adequate for a response, and as to anything peculiar in themselves. Items out of date (which ought to have been responded to) should be reported to Head Office.
>
> The auditor cannot be expected to test valuations, but should see that the whole of the inventories are in, have been duly certified by proper persons, and are summarized accurately.
>
> As respects issues of goods
> (a) to fur stations
> (b) to shops
>
> there is doubtless a systematic record of such issues and a proper officer (other than the auditor) whose duty it is to see that these are acknowledged and a note made systematically of the fact. The auditor might see whether any acknowledgment was wanting which ought to have been received.
>
> The only real test on the receipt side of the cash account is the making out and keeping of books, invoices

> and statements for debtors by men <u>who do not handle cash</u> and the certainty that if each was not duly credited to debtors these men would apply for payment until proof was afforded by such debtors that payment had been made.
>
> As regards sale shops, a custom has been in use here of invoicing all goods to sub-stores at fixed nominal prices, so that in sale books both nominal and real prices are shown and the stock, taken at nominal prices must agree. It is for your commissioner to consider whether this plan can be employed but it would have little to do with the audit.
>
> [signed Thomas Welton]

This arrangement was observed by Deputy Governor Skinner and committee member Burbidge when they toured the HBC's Canadian operations in 1910 for the purpose of assessing retail opportunities [HBCA. A.12.203.1.43]. Skinner was knowledgeable on financial matters, while Burbidge understood retailing since he was the managing director of Harrods Limited, the London department store. Instead of part-time bank managers and the HBC's accounting staff, they recommended a professional auditor. Two reasons were given. First, Canada-based HBC accountants, as subordinates, were not able to question the vouchers of the three commissioners. Second, the pending retirement of a Bank of Montreal manager provided an opportunity to change the process. Skinner and Burbidge wanted professional auditors for the growing Canadian operation rather than an ad hoc combination of accounting employees without independence and part-time bank managers. Marwick Mitchell, an American firm with a Winnipeg office [Boys, 1989], was contacted. Marwick Mitchell presented the HBC with an external audit proposal that included purchasing, sales, cash, capital and revenue expenditures, accruals and allowances, inventories, bad and doubtful accounts, land department, stores, general, reporting, and remuneration [HBCA. A.12.203.1.51-59]. The firm was hired with the governor and committee reducing the scope: "Instead of the exhaustive method proposed, the [governor and committee] desire Marwick Mitchell…audit Winnipeg books as at present kept for the current year beginning February first" [HBCA. A.12.203.1.63].

MANAGEMENT ADVISORS

The growth in British joint-stock companies during the last half of the 19th century encouraged shareholders to demand that the company exert fiduciary responsibility. In this context, the HBC operations in Canada were evolving from entirely barter trade to cash transactions. The operating or management accounting statements for barter had been relatively simple with relatively few different accounts.

A memorandum dated April 30, 1889 from the external auditor, Thomas Welton, to the London governor and committee lamented the condition of the fur trade or operating statements and made recommendations for improvement [HBCA. 67.26.17]:

> The mode in which the company's accounts are kept is essentially that of single entry.[3] The London books no doubt are on a double-entry basis, but as the outcome of each successive outfit is merely an inventory of assets plus the shipments made to England, there are no means of preparing an orderly statement of Profit & Loss, or of arriving at a regular comparison of one year's business cost with that of another year. It is not shown for example what the payroll of the fur trade was in any year, nor what money was drawn by the several stations from the chief offices on the other side, in addition to the stores and goods forwarded to them respectively, nor to what use such money was applied.

In a barter economy, the HBC had a meaningful list or chart of accounts; all inventories, trade goods and supplies, could be lumped together without clearly differentiating between cost of goods sold and inventory. The replacement of barter with cash meant there were in the HBC's Canadian business for the first time cash transactions, (i.e., cash outlays to pay for trade goods and supplies purchased from vendors in Canada and cash inflows from Canadian customers). Welton noted that the accounting for these cash flows with the barter system was to add or subtract these flows of cash from the overall cash generated from the fur trade. When cash transactions were a small part of the business, this was not a problem. However, by 1889, these cash transactions were a significant part of the business, thereby distorting the fur-trade accounting statements.

Welton believed that the wide variety of items included in the specific balance sheet item, "inventory," led to inaccurate information. As an example, Welton stated "(a) large increase

[3] At the time that these changes were being proposed, a part of the work of external auditors involved introducing double-entry bookkeeping [Edwards *et al.*, 2007, p. 83].

of payments might indicate a new policy of purchasing supplies elsewhere than in England, or might mean that a greater portion of the furs shipped had been purchased for cash" [HBCA. A.67.26.21-22]. His contention was supported by item 70 of the HBC's 1887 "Rules and Regulations," which showed the components of inventory to include such heterogeneous assets as trading goods, supplies, country-made articles, livestock, outstanding balances, buildings and land, ships, etc. [HBCA. D.24.9.13]. Welton's recommendations led to the division of the inventory account into cash, goods held for barter, furs and country produce, livestock, ships and steam boats, and other assets. The purpose was to differentiate between the amounts of assets and liabilities for current accounts, for barter, and for other purposes [HBCA. A.67.26.17-23]. This was the first time in more than 200 years that the Canadian operation reported fixed assets.

To ensure proper recording of cash transactions and communicating those transactions, Welton further recommended the following records be sent to the London accounting office: receipts and payments in account with head office; receipts and payments in account with officers and servants; receipts and payments in account with persons having current accounts; receipts and payments connected with the fur trade, under several headings.

Welton's recommendations led to the trading account which is shown in pre-printed format in Exhibit 1. The trading account replaced the balance sheet as an operating statement. With the previous barter trade and no-fixed assets, the balance sheet could satisfactorily calculate profitability. Welton's recommendations led the HBC to manage its fur posts and saleshops with financial information.

By 1896, some of the pre-printed forms had been customized for the saleshops which had been established in 1871 [HBCA. D.24.11.1-9]. An important change to performance measures was the reporting of the return on capital employed (ROCE) by fur posts and districts, and saleshops. ROCE was the profit or loss from sales divided by the capital employed. With the HBC operating almost entirely in a cash economy, the financial records became more detailed and were used more frequently because of improvements in communications and transportation.

EXHIBIT 1

Trading Account Format

Trading Account ________________District Outfit 1910, Form 20
To inventory of goods
To goods from depot and mills
To goods and country produce purchased
To goods from other posts, etc.
To freight on goods
To insurance on goods ____________

By supplies on expense accounts
By supplies on servant accounts
By supplies to other posts, etc.
By inventory of goods ____________

Net cost of goods sold
By cash sales
By credit sales
By bartered for furs, country produce
Gross profit (Per cent. Of C.L.)

Add - Gain on: live stock, bad debts recovered, fur purchased, [Aboriginal] debts recovered
____

Less - Expenses as per Form No. 14
Repairs and improvements (annual depreciation)
Loss on articles at fixed prices (goods depreciation)
Loss on: bad, doubtful, [Aboriginal] debt ____________
Apparent gain

============

Furs purchased
Cash
Freight, insurance, packing, etc.
Bartered for goods
Credit [Aborigines]
Credit Customer ____________
Cost
Tariff valuation

Gain exclusive of profit on goods bartered

____

============

Source: HBCA. D.31.14.

These actions of the external auditors were expected of the "professional" external auditor. In 1883, *The Accountant* was quoted in Maltby [1999, p. 43] as saying:

> A true audit…goes far beyond the checking of vouchers, items and balances. It means behind the scenes, searching out the causes by which the effects have been created, the discovery of managerial errors, and the suggesting of remedies. A true auditor is in the confidence of his client. The latter almost invariably consults him on matters for removal from the simple question of the balance-sheet and profit and loss.

Welton was obviously a "true auditor."

CONCLUDING COMMENTS

The regulatory requirement for external audits in many industries in the last 40 years of the 19th century was a major event in the development of the public accounting profession. Similarly, the 1866 introduction of external auditors was a significant accounting event not just for the HBC but for other public companies as the driving force was not regulation. It was the shareholders who saw the benefits and who requested that the financial statements be audited to make them more useful. In that way, it was an early example of shareholders and managers with external auditors working together in pursuit of standardized and informative audited financial statements. The purpose was to provide the shareholders with a better understanding of the company's ability to pay dividends and to expand in North America.

The introduction of the external auditor at the HBC was a result of three forces that reinforced one another. First, the HBC's shareholders that came after the IFC were more demanding then prior owners. Second, there was a capacity among London accountants to provide external audit services. These external auditors were keen on pursuing new businesses and turning themselves into a new knowledge profession. Third, the British Parliament was passing various acts for regulated companies that required audited financial statements. Even when regulation was missing, this signalled that audited financial statements provided more useful information than unaudited ones. In this context, the HBC appointed external auditors decades before legally required to do so.

The external auditors also had a significant impact on how internal or management accounting was conducted. With the

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HBC, external auditor Welton assisted with the transition of the management accounting from a barter economy to one in which cash predominated. The external auditor's recommendations were completely accepted. In this way, the external auditor served as an advisor to the HBC's management for improving the precision and thereby the effectiveness in using financial information to manage the hundreds of fur posts and saleshops.

The HBC had a long history with its external auditors. When the HBC's head office was moved from London to Canada (Winnipeg) in 1962, the board (the name for the governor and committee after 1930) decided it only needed one external auditor. The London external auditor from 1918 to 1962 was Deloitte, Plender, Griffiths & Company. The Canadian external auditor from 1911 to 1962 was Peat, Marwick, Mitchell & Co. Since more than 90% of the HBC's operations were located in Canada, the board recommended that the Canadian external auditor be appointed for the entire company. Peat, Marwick, Mitchell & Co. was appointed the sole external auditor for the HBC, and remained so until 2005, but with the name of KPMG LLP.

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THE ROLE OF FINANCIAL ACCOUNTING IN INVESTING IN 1870s AMERICA

Abstract: The objectives of this study are to understand better the development of investment practices and the information that was available for those practices during the turbulent decade of the 1870s. This was a time of panic, depression, and manipulations by insiders. Nevertheless, outsiders chose to speculate and invest in corporate securities in Wall Street. Consequently, authors began to provide more specific investment advice, some of which required the use of earnings and other financial-accounting information. This study describes the availability of that information in the books and periodicals in an age dominated by railroad kings.

INTRODUCTION

Financial accounting became important to the securities markets in America in the late 1840s. At that time, the markets were called upon to provide significant amounts of capital to railroads, the first modern businesses. Since the markets were little more than rigged casinos, it was hoped that financial accounting and other information would help investors make rational decisions. Information was viewed as a means to defeat stock swindlers and manipulators who took advantage of the uninformed [Thompson, 2008].

However, authors prior to 1870 provided little guidance on how information should be used to select corporate securities. They focused on educating investors and providing information to assist in the purchase of securities that had "intrinsic value" [Armstrong, 1848] or were "well-authenticated" [Hamon, 1865]. This paper examines what advice authors gave to investors to make decisions and what information was available to them for making those decisions. As such, it contributes to our understanding of the development of investing and financial accounting. It helps explain how financial-statement analysis went

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from virtually non-existent in the 1840s to methods in the 20th century.

This article is based primarily upon books on investing published in the 1870s. As in a previous article [Thompson, 2008], these books were identified using WorldCat [2007], employing a fairly comprehensive set of search terms related to investing and railroad manuals. Stipulations included that the books were published in America, focused on the New York Stock Exchange (NYSE), were general works on investing in corporate securities, and were available through interlibrary loan. The information derived from these books was supplemented by periodical literature of the day.

This article is organized as follows. The stock market of the 1870s and its operations are discussed in the first two sections. Contemporary investment advice, including the first model for making investment decisions expounded by an American author, is described in the subsequent section. Available investment information is surveyed in the next section and a synthesis and conclusion complete the study.

THE STOCK MARKET IN THE 1870S

The NYSE had grown dramatically over the years. The conduct of business had grown more than 200-fold by 1870 compared to 1838, and it had become a $3 billion market [Medbery, 1870]. About this time, 100,000 shares typically traded in a day.[1] In 1875, the daily volume of business transacted on the NYSE approached $50 million compared with $20 million, including gold trades, in 1865 [Tumbridge, 1875; Stedman and Easton, 1905; Gordon, 1999].[2]

Table 1 shows the domination of railroad securities on U.S. exchanges.[3] These securities helped finance the doubling of railroad track mileage from 39,250 miles at the end of 1867 to 81,841 miles at the end of 1878 [Poor, 1879]. Other industries that grew in the aftermath of the Civil War did not usually rely upon the securities markets for financing.[4]

[1] By comparison, in 2000, the market capitalization of stocks listed on the NYSE was over $12 trillion, with an average daily trading volume of over one billion shares [Wright, 2001].

[2] The technology of the NYSE was also changing with telephones first used in November 1878. Stock quotations had been reported by tickers starting in 1867 [Eames, 1894].

[3] There were also a large amount of bank and insurance stocks that were considered "local" and, as will be seen later, were not actively traded.

[4] For example, retailers and wholesalers relied upon commercial banks and

TABLE 1

Numbers of Securities on U.S. Exchanges in 1870 (Principal Cities)

Industry	Stocks	Bonds
Railroad	192	736
Canal	15	30
Coal	12	—
Gas	12	—
Telegraph	2	—
Express	4	—
Steamship	2	—
Trust	5	—
Mining	4	—
Street Passenger Railroad (New York & Brooklyn Cities)	21	29
Miscellaneous	—	8

Source: Dana & Co. [1870]

During the early 1870s, the NYSE was affected by corners in Reading, Rock Island, and Chicago and Northwestern, major fires in Chicago and Boston, and the Oakes Ames scandal involving the Union Pacific Railroad and the Crédit Mobilier of America (CM) [Fowler, 1873; Lapsley and Bazley, 1874].[5] However, the Panic of 1873 was the most notable stock-market event of the 1870s.

The failure of Jay Cooke & Co. on September 18, 1873 precipitated the panic. As underwriters of Northern Pacific Railroad bonds, Jay Cooke & Co. was to pay 85 cents on the dollar for the bonds. However, it was obligated to pay the Northern Pacific interest on any unsold bonds. Jay Cooke sold less than $20 million out of a total of at least $60 million. Consequently, it could not keep up with the interest payments, resulting in the firm's failure [*New York Times* (*NYT*), 1873d]. Jay Cooke came to national prominence by selling U.S. government bonds during the Civil War, often with little or no compensation [*NYT*, 1873b].

The panic produced runs on financial institutions as depositors lacked confidence in the safety of their deposits [*NYT*,

cash flow to finance their operations [Chandler, 1977]. Two notable companies that began in the 1870s also did not need the security markets. Carnegie's Edgar Thomson Steel Company was a limited partnership [Livesay, 1975], and the stock of the Standard Oil Company was held by six people [Chernow, 1998].

[5] The CM was the construction company for the Union Pacific. Oakes Ames, one of CM's stockholders and a congressman from Massachusetts, sold CM stock among his colleagues with the intention of receiving a favorable view by Congress toward the financing of the Union Pacific [Seitz, 1926; Gordon, 2005].

1873c]. An estimated 20,000 people were financially ruined within two days, and losses amounted to at least $20 million [Smith, 1873]. The NYSE closed for ten days from September 20-30 [Fowler, 1873]. By the end of 1873, 57 NYSE-listed firms had failed [Eames, 1894]. In addition, over 300 banks failed [Geisst, 2004] and, by the end of the decade, 287 brokerage firms were bankrupt [Gordon, 1999].

Railway stocks suffered the most, including those owned by Vanderbilt [*NYT*, 1873e]. Stocks hit their lowest prices on November 7, 1873 [Fowler, 1873]. As of that day, for the 15 stocks for which the *NYT* reported closing quotations on September 12, 1873 (before the trouble began), the average loss was 39.5%. The losses ranged from 21.5% for the Chicago and Rock Island to 54.0% for the Hannibal and St. Joseph [*NYT*, 1873a, 1873h].[6] Even worse, railroad stock prices lost an average of about 50% by 1878 [Gordon, 1999].

One of the consequences of the panic was the onset of a business depression [*NYT*, 1873g] that lasted most of the decade. In 1876, 134 railroads were in default on $500 million in bonds out of $2 billion outstanding [Sullivan, 1876]. Railroad earnings did not recover until after 1878 [Poor, 1879].[7] By the end of the decade, 65 railroads were bankrupt [Garraty, 1995, p. 501].

However, speculation returned to Wall Street in fall 1879. A record number of 681,810 shares were traded on November 20, 1879 [Stedman and Easton, 1905]. This return to speculation was accompanied by reorganizations of railroads and their bonds, benefiting "speculators who had bought up their old stocks and bonds at little or nothing, thus 'reconstructing' immense fortunes for themselves while saddling the reorganization with a weight of indebtedness as great or greater than before" [*American Railroad Journal* (*ARJ*), 1879a, pp. 1,149-1,150].

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[6] The *NYT* reported the actual transactions (number of shares traded and price) in stocks at the NYSE. In a separate table, it reported the opening and closing prices for 15 stocks.

[7] Some contributing factors were railroad strikes in 1876 [Stedman and Easton, 1905] and Granger laws that had a negative impact on the prices of railroad shares [Eames, 1894]. More importantly, the five major trunk lines that connected the west with the shipping ports on the east coast were grappling with competition among themselves [Adams, 1888].

THE NATURE OF SECURITY MARKET OPERATIONS

Some commentators attributed the Panic of 1873 to an overbuilding of railroads and a shortage of money as surplus crops were coming to market [Fowler, 1873; Clews, 1887]. However, other authors thought a more fundamental cause was excessive speculation [Smith 1873; Stedman and Easton, 1905]. Sullivan [1876, p. 101] noted that there were two aspects of Wall Street, "the substantial or investment [and] the speculative or visionary." The former helped the country's industry while the latter caused wealth to be made or lost. *Banker's Magazine and Statistical Register* (*BM*) [1879, p. 19] lamented the existence of speculation since "it diverts to the occupation of gambling, which is essentially unprofitable in a public point of view, an incalculable amount of time, energy, and talent." Walker [1878, p. 40] added that "the rashness of those who hover around the vortex of stock speculation is not rashness merely, but probable perdition."

Fowler [1870, pp. 132, 534] explained the motivation for a speculator: "*the hope of gain* is a stronger principle in human nature, than *the fear of loss*." (italics in the original) He added: "They lose everywhere, buying stocks, selling stocks; by failures of their brokers, by frauds of their contractors, by panics, by corners, by tricks and stratagems of the market." Smith [1870, pp. 157, 544-545] also explained the urge to speculate: "The haste to be rich, by a lucky stroke of fortune, by hazarding a few thousands in Wall Street, is the same spirit that leads thousands to the gambling table." Some lost because of their own actions, others were fooled. Unfortunately, "Ninety-eight out of every hundred, who have to do with the Street, are cleaned out and ruined."

Various methods were used to take advantage of unwary investors and speculators. One was through "points, a bit of secret information concerning a stock…which will seriously affect prices" [Medbery, 1870, p. 83]. Today, the securities acts prohibit trading on such secret or inside information. Moreover, Regulation FD mandates disclosure by a corporation to the public of material information that could affect its stock's price [Sharpe, 1981; Malkiel, 2007]. Yet, in the 1870s, these points were useful as long as "*you have not been misled*" [Medbery, 1870, pp. 83, 86]. Medbery added that "half the failures of the street are due to points which brokers believe in, not only to their customers' but their own ruin." Fraudulent newspaper articles were also extremely influential "if a favorable notice can be secured for a handsome check, it is regarded as well laid out" [Smith, 1870, p. 520]. In fact, Jay Gould, the aforementioned stock operator *par excellent*, owned the *New York World* and used it to aid his schemes [Josephson, 1934].

"Corners" were also a popular device of manipulative pools [Medbery, 1870]. Essentially, these involved controlling, through ownership or buying contracts, most of the shares available for a corporation.[8] This trapped (cornered) the "shorts" (the sellers), forcing them to pay an exorbitant amount for the stock in order to fulfill their contracts.

Corporate directors deceived stock owners by issuing more than the authorized number of shares and by paying dividends out of capital [Medbery, 1870; Smith, 1870]. This was long before Ponzi schemes were so-named in the 1920s, which Bernie Madoff popularized in the contemporary world [McCoy, 2009]. In addition, corporate directors often had a conflict of interest. For instance, Gould, as a director of the Union Pacific, threatened to develop a competing railroad. He strung together a number of railroads and planned an extension that would have bypassed the Union Pacific by connecting the Central Pacific in Utah with the Lake Shore Railroad in Ohio. To avert the competition, the Union Pacific acquired the proposed line, benefiting Gould and other directors of the Union Pacific who held stock in the acquired railroads [Stedman and Easton, 1905].[9]

Abuses like these were often easy to perpetrate since railroad ownership was concentrated in the hands of a relatively few (e.g., Vanderbilt, Gould, Scott, Garrett, Huntington, Mitchell, Jewett, Garrison, Field, and coal railroad owners). Through their stock ownership and the related control of their companies' bonds and leases, these "railroad kings" controlled approximately $3.3 billion of the $4.5 billion railroad capital in the U.S. These amounts dwarfed the nation's $720 million in banking capital and $369 million in states' debt. Moreover, railroad capi-

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[8] These contracts, essentially futures, were buyer or seller options for 3, 10, 30, 60, and 90 days [Medbery, 1870]. A buying contract allowed the issuer to buy stock from a seller, while a selling contract allowed the issuer to sell stock to a buyer. In a buying (selling) contract, the buyer (seller) could give one day's notice to complete the sale during the term of the contract or otherwise must have bought (sold) when the contract came due.

[9] However, Gould claimed that he resigned as director of the Union Pacific shortly before the acquisition [Clews, 1887]. During this same period near the end of the 1870s and into the early 1880s, Gould orchestrated other schemes including obtaining control of Western Union and the elevated trains in New York City [Stedman and Easton, 1905].

tal was almost twice as large as the $2.3 billion debt of the U.S. [*ARJ*, 1879b].[10]

Despite this domination by a handful of individuals, many Americans owned railroad securities, including those living along railroad lines. Even clergymen and women speculated at times. These "outsiders" sent from 850 to 2,300 daily telegraph orders to the NYSE [Medbery, 1870]. In 1879, as many as 30,000 outsiders participated in the stock market [Fowler, 1880].[11] It was for these outsiders that the authors of the 1870s began to offer advice. This advice was more specific than that offered by prior authors.

SELECTING SECURITIES

Rules for Outsiders: Fowler [1870, p. 117] advised: "Buy only on the amplest margins. Be an occasional not a constant operator. Cut short your losses, and let your profits run. Never sell what you have not got."[12] Walker's [1878, p. 40] two rules were: "Never borrow money to speculate with. Never speculate so deeply but that, if you lose all, you will not feel it." Medbery [1870, p. 230] discouraged outsiders from buying on margin: "If they purchased 'out and out,' the whole aspect of things would change. The cliques would not control as at present, and speculation would become an affair of relative judgment." Barnes Garrison & Co. [late 1870s, pp. 5, 7] suggested: "Always go with the tide… Never buy stocks immediately after a strong 'bull' campaign, nor sell them just after a sharp 'bear' movement." They added, in what was essentially a technical-analysis approach, "Where a stock has once been in price, you may look for it to sell there again at some time."

Some of this advice is still around. Malkiel [2007, p. 372], for example, believes in "the Wall Street maxim 'Ride the winners and sell the losers.'" He also believes in trading as little as possible. Similarly, Cramer [2005] advises not borrowing a lot of money to invest, selling losers, and staying with winners. Investors should also [Cramer, 2006, p. 155] "Follow the Street's

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[10] William H. Vanderbilt would soon sell $30 million of New York Central common stock. While Vanderbilt maintained that he did this to placate the public on its charges of monopoly, others thought that this was simply a good time to sell as the value of the New York Central was not likely to increase [*ARJ*, 1879c].

[11] Foreign investors in American securities tended to buy debt securities, many preferring government bonds. In total, British investors owned $1.1 billion of American securities in 1876 [Baskin and Miranti, 1997].

[12] Margins of 10% were typical, although for more speculative securities, the required margin could be more [Medbery, 1870].

lead." Moreover, Buffet does not believe in using much debt for investing [Schroeder, 2009].

Others pursued more of a fundamental-analysis method. *Hunt's Merchants' Magazine and Commercial Review* (*HMM*) [1870a, p. 106] demanded greater publicity of financial information, noting that "the current value of railroad stocks is regulated by the current earnings of the road." When investing in stocks or bonds, Sullivan [1876, p. 101] suggested that "the principal and interest should be secure beyond question." Toward this end, Sullivan advised to "ascertain the amount of stock or bonded indebtedness, or both; the scheme or object represented; if a railroad, the cost per mile, the demands and productiveness of the country through which it passes." Other considerations included whether an acquired security could be used for collateral or sold in the event cash was subsequently needed.

When speculating, as opposed to investing, Sullivan [1876, p. 102] advised to stay away from "'fancy,' or stocks of no intrinsic value, non-dividend paying, and subject to the wildest fluctuations." Recent examples of such stocks include the internet bubble at the turn of the 21st century when companies were evaluated by the number of website visits, how long visitors stayed, or how many miles of fiber-optic cables had been laid [Malkiel, 2007]. Sullivan [1876, p. 102] believed that only insiders or those with a controlling interest could make money with fancy stocks. As with investment, Sullivan's cardinal rule was safety of principal and interest. In addition, he required that both controlling stockholders and its officers were honest, with the interests of the company being their utmost goal. Such stocks "must not be looked for, however, with the flattering hope of getting rich in a day, for their fluctuations are small, yet they are sure."

Medbery [1870, p. 203] believed that outsiders should buy low and sell high and that "the advice is not more sound than feasible." Those who succeeded "watch the market, study the earnings of companies, look into the character and bent of mind of directors, and when certain stocks fall to a reasonable figure they buy, generally upon wide margins." His advice is similar to that of Warren Buffet [2001].

Moreover, sounding quite modern, Medbery [1870, pp. 204, 210, 217] believed that stock price changes were primarily due to "excess or want of confidence." He observed that stock prices often moved together and that "in its panics, Wall Street is especially unreasonable. Indeed, there is not a safer method of profit in existence than to watch the periodical depressions of securities; and to buy, buy, buy as soon as the downward pressure is fully under way." He added that such stock price changes were common and occurred every year. Unfortunately, "To buy at the crest wave of extreme advance and to sell at the lowest ebb of the tide, are what brokers assure us to be the judicious customs of ninety out of a hundred of the people who bewail their inexplicable misadventures in stocks!" As an alternative, Medbery suggested a more comprehensive approach by formulating an investment model, the first known American author to do so.

Medbery's Investment Method: Unlike the other authors, Medbery [1870. p. 207] developed a valuation model for stock prices, noting that "the method is not difficult in its arithmetic, and has doubtless a certain use, as illustrating the difference between the selling rate of stocks and their theoretical value." He explained his method for a stock which pays a dividend of 7% on a par value of $100: "Thus, where money brings easily seven per cent a year, it is clear that a stock ought to have par value, provided the company which it represents is managed with such care as to insure the property from future injury in its earning power." He further added that:

> if the same stock should permanently pay eight per cent, its true value in the market would be the equivalent of that sum, which at seven per cent would give eight dollars in interest. Were a capitalist to buy the stock at 114 2/7, his annual dividend would be precisely what the same money would be worth at .07 per year.

In other words, the price of the stock is that amount needed to generate a fixed dividend each period at a constant money rate (price x .07 = $8, or price = $8/.07 = $114 2/7). In modern terms, this is equivalent to modeling the price of a share of stock as the present value of a constant dividend per period in perpetuity discounted by a constant interest rate [Sharpe, 1981]. For Medbery's example, $114 2/7 is the present value of the $8 dividends received in perpetuity discounted at 7% per year.

Using his model, Medbery provided actual examples of mispriced securities. He considered examples of bank and railroad stocks, showing the difference between the market price and the theoretical value using a 7% money rate. He concluded that, "With the exception of a few of the banks, it has been seen that the table affords a near average of the intrinsic worth of the stock cited above." Medbery [1870, pp. 221-222] cautioned that, "The reader ought to thoroughly understand, however, that there is no royal road to speculation." Moreover, "Integrity and ability in directors, the earning capacity of the property of a corporation, the chances of the future as well as the past, are essential points to the final judgment, and the rates of the Exchange are averagely the measure of increasing or decreasing faith in the dividend worth of a security."

Medbery [1870, pp. 209, 229-230] noted that his model had been around for some time: "Seventy years ago a chart classifying the great British funds, according to ratios similar to tables just presented, was published in London." He added that the model should have aided users to become wealthy. However, it had not always been applied successfully because of "suspicion, over-confidence, timidity, vacillation – each and every element which has made the prices of all financial centres through early and latter days fluctuating, unstable, hazardous." He observed that "This weakness of humanity is the life of speculation." Moreover, regarding the use of his model, Medbery lamented that:

> Brokers tell us that about one in a hundred buy in this manner. The ninety-nine mean to do so. They make their calculations, add up, subtract, wander hither and thither for points, try this system and that theory, are wise to the extent of their wisdom, and come forth from their ventures shorn of all their golden fleece. With a chart of prices before one, this fatality seems inexplicable.

AVAILABLE INFORMATION

Medbery, Sullivan, and others [*HMM*, 1870a; *NYT*, 1873f] suggested obtaining information on earnings, costs, capital structure, dividends, integrity of management, and prospects for the future in selecting investments. Focusing on railroads, this section describes the investment information contained in various volumes, periodicals, and manuals during the 1870s. Railroads' annual reports were not reviewed. Setting aside the difficulty of currently obtaining them, a more compelling factor is that annual reports were not always as complete as the information available elsewhere, especially in railroad manuals [Chandler, 1956]. In addition, as late as 1926, investors did not usually examine annual reports or other primary documents, such as corporate charters. Instead, they relied on manuals and periodicals [Lyon, 1926].

Miscellaneous Volumes: Miscellaneous volumes commonly provided tables on high and low prices for railroad securities. Failing [1870], for example, included a table, covering three years, containing annual high and low prices for about 40 bonds, common stocks, and preferred stocks. Sullivan [1876] presented a similar table, covering the years 1860 through 1875. Other authors [Dana & Co., 1870; Horton & Co., 1878] provided monthly high and low prices. Monthly tables were often given by brokerage houses as an enticement for speculators to buy stocks or privileges (options).[13]

Another type of table commonly available contained basic descriptors of stocks and bonds. Failing [1870] had a table of 68 railroad stocks showing par, capital paid-in, shares outstanding, dividend rate, and dividend-payment dates. Dana & Co.'s [1870] table showed the same information along with date of last dividend payment and bid and ask prices. Sullivan's [1876] table for 27 railroads listed capital stock, par value, dividend-payment months, bonds outstanding, latest net earnings, and funded debt of road property. Note that he provided slightly more information by including net earnings and debt information. Dana & Co.'s [1870] railroad bond table briefly described the issue (e.g., first mortgage, convertible) and provided amount outstanding, interest rate, when and where interest was to be paid, maturity date, and bid and ask prices.

Dana & Co. [1870] included other tables on railroad mileage and earnings. It also summarized economic conditions of 1869, and gave an overview of major economic issues: government debt, foreign trade, crop production, real estate values, Wall Street speculation, and railroad construction. Reflecting a future orientation for the upcoming year, Dana & Co. [1870, p. 73] did "not anticipate a *general* and *material* increase in railroad earnings over the year 1869." However, it noted that "the old and well known favorites on the Stock Exchange will do well, and in fact, be very prosperous, if they can show during the coming months of the new year a report of earnings which will compare favorably with the same months of 1869." Long ago, investment practices included a future outlook, a perspective that continues to this day [Cramer, 2005].

Periodicals: One of the popular periodicals of the mid-19th cen-

[13] Privileges, what are now called options, included calls, puts, spreads, and straddles (double privileges). They allowed the holder to buy or sell stock at a fixed price, typically during a 30-day period.

tury was *HMM*. In 1870, this monthly magazine contained business articles, banking and economic data, government reports, and notices of issues of new securities. Its section entitled "Commercial Chronicle & Review" discussed business, money-market, bond-market, and stock-market conditions. Another section on "Railroad Items" provided mostly short notices on conditions and progress of individual railroads. Thus, general business news was available to *HMM* readers.

Quantitative data were also included. Similar to the miscellaneous volumes discussed previously, there was a focus on pricing information. In February 1870 [*HMM*, 1870b], one table showed monthly high and low prices for railroad stocks for 1869. Another gave the opening, highest, lowest, and closing prices for selected securities during each of the prior two months. Also provided was industry sales volume for the month for shares traded on the NYSE. Remarkably, in January 1870, of the 896,596 shares traded, 781,340 were railroad shares (87%).

Financial-accounting information played a significant role in *HMM*. Comparative year-over-year monthly earnings and earnings year-to-date were reported for selected railroads. Even detailed income and balance-sheet information was sometimes included, such as for the Reading and the Louisville and Nashville Railroads [*HMM*, 1870c]. Tables were periodically published covering railroads in a handful of states, such as Ohio and Massachusetts [*HMM*, 1870d]. The table for Ohio included for each railroad, length, cost, capital stock, funded and floating debt, earnings (passenger, freight, and total), operating expenses, net earnings, interest paid, and dividends. The tables for other states were similar.

Reflective of the changing times, the monthly *HMM* was merged, beginning in 1871, with the newly born (July 1865) *Commercial and Financial Chronicle* weekly. An editorial explained [*HMM*, 1870f, pp. 401-402]:

> the increased rapidity of communication between cities and nations by means of railroads and telegraphs has changed into quicker movement all thought and action by individuals and communities...Thus it became evident, some time since, to the publishers of the *Magazine* that the infrequency of its issue (only once a month) prevented its keeping pace with the growing wants and necessities of the community. Its information was too late to be of present use.

The new *Commercial and Financial Chronicle and Hunt's*

Merchants' Magazine (*Chronicle*) was to be supplemented by an annual volume that "shall contain all the yearly statistics, &c., necessary for Bankers' and Merchants' use, in form easy of reference, with reports of the different branches of trade, &c."

By the end of the decade, the *Chronicle*, the leading financial periodical of the time [Geisst, 2004], offered a compendium of information.[14] The breadth was amazing. The three key parts of the *Chronicle* were the weekly issues, the monthly "General Quotations of Stocks and Bonds," and the monthly *Investor's Supplement*. In Its July 1879 issues, the *Chronicle* [1879 b, c, d, e] provided general business news like its predecessor *HMM*. There were articles, banking and economic data, a weekly column on commodities and railroad traffic, and a weekly column on the money market and securities. Also reported were the dollar values of transactions in bonds (U.S., state, and railroad) as well as the number of shares traded on the NYSE. Comparative prices over three years were given for New York City bank stocks, money, gold, exchange, U.S. bonds, railroad stocks (12 issues), and merchandise.

Price and volume information for stocks and bonds were important. One table reported the opening, high, low, and closing stock prices for the most recent two months for railroads (68 security issues), telegraph (4), express (4), coal & mining (12), and various (7). Another table showed the daily high and low prices during the most recent week for 39 stocks. For these issues, a table provided the number of shares sold during the most recent week and the lowest and highest prices year-to-date and for the previous year. For seven issues, a table displayed the daily trading volume during the past week, the weekly total, and the total shares outstanding. In addition, fairly long tables provided recent bid and ask quotations for stocks and bonds. For railroads with "Active Previously Quoted" securities, 29 stocks and 219 bonds were included. Tables on New York local securities covered banks, gas, city railroads, and insurance companies. Moreover, the initial January issue [*Chronicle*, 1879a] reported the monthly high and low security prices for the prior year.

As a current comparison, opening, high, low, and closing daily prices, volume data, charts, and additional information are readily available on websites such as Barchart.com. The *Wall Street Journal* (*WSJ*) [2010] provides stock data that were not

[14] The *Chronicle* maintained its preeminent status well into the 1920s. Lyon [1926, p. 52] referred to it as "the great thesaurus of current investment information."

contemplated in the 1870s, such as performance of stock indices, largest percentage gainers and losers, most active stocks, and volume movers. For bonds, the *WSJ* focuses on indices and the issues with the largest spread and price changes.

Financial-accounting information also played a prominent role in the *Chronicle*. One table had comparative monthly and year-to-date gross earnings. Another showed gross earnings, expenses, and net earnings for a different set of companies. Recent dividend announcements were included separately (percent, when payable, date that books closed). Additionally, included in the *Chronicle* were a few annual reports (some in detail). In all, a typical *Chronicle* issue was about 25 pages in length.

The last *Chronicle* for each month contained extensive tables entitled "General Quotations of Stocks and Bonds," covering stock and bonds traded throughout the U.S. These comprehensive tables contained far more securities than reported in the weekly issues. Table 2 lists by industry the number of securities with bid and ask quotations for July [*Chronicle*, 1879e]. Not included in Table 2 are bank and fire-insurance stocks in major cities other than New York, U.S. bonds, foreign-government securities, and state and city securities. In sheer numbers, railroad securities dominated except for bank and fire-insurance companies. These groups were not actively traded. Only about 1,200 bank shares were traded in May and June 1879 respectively compared with 5.5 million and 3.2 million railroad and miscellaneous shares [*Chronicle*, 1879b].

TABLE 2

Number of Securities Quoted by the *Chronicle* in 1879

Industry-Security Type	Number
Railroad Bonds	793
Railroad Stocks	240
Canal Bonds	33
Canal Stocks	10
Miscellaneous Bonds	23
Miscellaneous Stocks	25
Express Stocks	4
Gas Stocks	45
Manufacturing Stocks (mostly in New England)	55
Coal and Miscellaneous Mining Stocks	30
Boston Mining Stocks	23
California-Nevada Mining Stocks	85
New York City Bank Stocks	62
New York City Fire Insurance Stocks	75

Source: *Chronicle* [1879e]

The *Chronicle* also published an *Investor's Supplement* on the last Saturday of each month. After a discussion of investments for the month, extensive stock and bond tables were presented. These gave basic security descriptors. For railroad stocks and bonds, the tables provided description, miles of road, date of bonds, size of bond issue or par value of stock, dollar amount outstanding, and interest or dividend information (e.g., interest rate, last dividend date for stocks, etc.). Brief notes on the company or issue were appended. Again, railroad securities dominated with tables covering 16 pages compared with three for state securities, seven for city securities, one for canal stocks and bonds, and one for miscellaneous stocks and bonds [*Chronicle*, 1879f]. In all, the *Investor's Supplement* was typically around 30 pages in length. These comprehensive pricing and security descriptor tables supplemented data available on a weekly basis for selected security issues.

Unlike the *Chronicle*, the weekly *ARJ* focused more exclusively on railroads, although some information was usually given on state and U.S. government securities.[15] Almost half of the *ARJ* was devoted to two main tables on railroad securities, "American Railroad Bond List" and "Railroad Share List." These tables followed the same formats in the 1870s that had been adopted in the 1860s [*ARJ*, 1869, 1879d]. The bond list had basic descriptors for each listed bond issue – dollar value, interest rate, when and where payable, due date, and price. Table 3 shows the contents of the share list. Note the inclusion of financial-accounting information. For the December 26, 1879 issue [1879d], there were 1,283 issues listed in the bond table and 318 issues in the stock table.

Two other *ARJ* tables dealt primarily with railroads. One showed for 229 railroads stock outstanding in dollars, dividend-payment dates, and last dividend date; the other displayed monthly earnings for three to six years for 21 railroads. Daily stock and bond prices for the most recent week were reported for selected companies on the New York, Philadelphia, Boston, Baltimore, and London stock exchanges. Weekly price ranges were given in lists for additional selected stocks and bonds traded in New York, Philadelphia, Boston, and Baltimore. Also included in the *ARJ* were short articles, excerpts from an-

[15] A third periodical of the time, *BM* emphasized banks and banking although it routinely reported selected stock prices for 25 companies, mostly railroads. It also included commentary on the stock market.

TABLE 3

***ARJ* Railroad Share List Information**

Identifiers – name, states of operation, year ending

Railroad mileage – main line, branches, second track and sidings, in progress, operated

Rolling stock – engines, passenger cars, B. M. & E. cars, freight cars

Abstract of general balance sheet: property and assets – railroad, rolling stock, and other assets; accounts and cash; liabilities – stocks, bonds, accounts, and surplus income

Operations – miles trains moved, number of passengers, tons of freight

Earnings – gross and net

Dividend percent

Values of shares – par and market

Source: *ARJ* [1879d]

nual reports of railroads, brief announcements on earnings and directors, and a classified ad-type format for mostly dividend announcements. It contained a column titled, "Financial and Commercial Review," that discussed stock-market conditions, such as the activities of prominent bulls and bears, likely trends, and other economic matters. However, general business news played a less prominent role in the *ARJ* compared with the *Chronicle*. For the December 26, 1879 issue [1879d], 17 of the 28 pages of the *ARJ* were devoted to tables. Thus, on a weekly basis, the *ARJ* provided basic security descriptors, updated annual balance-sheet and earnings information, and price data. In contrast to the *Chronicle*, the *ARJ* published more financial-accounting information. However, even more financial-accounting data were provided in railroad manuals.

Railroad Manuals: The most detailed company information continued to be published in railroad manuals. A new work during the 1870s was the *American Railroad Manual for the United States and the Dominion* by Edward Vernon. This was the first edition of what was intended to be an annual edition. Vernon, who was formerly editor of *Travelers' Official Railway Guide*, expanded on his purpose in an introductory "Editorial." Vernon [1873, p. xlix] wanted to be impartial in presenting "the merits of each line, and to give an accurate exhibit of its financial condition, connections, and doings in transportation." On occasion, he planned to evaluate the railroads critically.[16] Like the compilers of other railroad manuals before him, Vernon noted that the information he wanted was not always available. In some cases, the officers of the railroad would not cooperate in providing the information at their disposal.

Vernon [1873, p. 1] was rightfully proud of the inclusion of railroad maps, believing he was the first to do so: "The illustration of a statistical work on railroads with such an elaborate series of maps originates with ourselves." However, Poor [1860] also did so in his first volume covering the railroads and canals of the U.S. Poor, however, was unable to complete his planned three-volume set because of the onset of the Civil War.

Most interestingly, Vernon [1873, pp. li, liii] wanted to create a table for each state, "systematizing all statistical information." However, due to difficulties, he did so only for Massachusetts and Ohio. The difficulties included different fiscal years, use of estimates in the place of actual results, and the lack of uniform accounting. With respect to the latter, Vernon penned an early plea for standardized financial reporting:

> There is also such an entire want of uniformity in keeping railroad accounts, and their subdivision, that an accurate estimate of the actual cost of railroad property is almost unattainable, especially as many railroad companies yearly expend large sums out of net earnings in permanent improvements, and charge to *operating* what should be legitimately debited to *construction*.

He added: "Our work in compiling these statistics would be materially facilitated if some definite rule were laid down by railroad managers as to what should constitute operating expenses."

Overall, Vernon's manual was 662 pages, and its general index contained about 1,000 railroads, including branch and leased lines. A majority of the write-ups were a half page or less. Thirty-nine of Vernon's write-ups were two or more pages.[17]

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[16] Contrast this aspiration with Poor's views [1860, preface]: "For each company no explanations of its acts or policy, or speculation as to the cause of its success or want of success have been offered." Poor added that, "All such would be worse than useless, as they would encourage a tendency, so strong in all, to substitute results that are desired for such as actually take place."

[17] Of over 750 entries in Poor's [1868] index (including U.S. and state debt,

Since it was his original plan of display, Table 4 shows the information for each railroad in Massachusetts. The table for Ohio was essentially the same except that it covered more debt instruments. These tables were comparable to those presented in periodicals of the time, such as the *ARJ* [1869]. Vernon, however, included some ratios and break-downs of earnings, expenses, and debt. On the other hand, unlike *ARJ*, asset costs were missing from these tables.

TABLE 4

Contents of Vernon's Table for Massachusetts

Characteristics of road – gauge and mileage for main, branch, sidings, total, and mileage in state

Capital stock and bonded debt – capital stock authorized, paid-in, preferred stock, first mortgage bonds, second mortgage bonds, unfunded debt, convertible bonds, total, and dollar amount for state

Rolling stock – number of locomotives, passenger cars, B & M cars, freight cars

Earnings and receipts – from passengers, freight, other (mail, express, rents, and miscellaneous), and total

Expenses – maintenance of way, locomotive repairs, car repairs, conducting and transportation, general, and total

Net earnings

Mileage statistics (ratios) – expenses to earnings, earnings per mile of road, expenses per mile of road, net earnings per mile of road

Percentage of dividends on stock

Source: Vernon [1873]

As for other states, railroad information was included in the write-ups for each railroad. These typically traced the history of the railroad from its original charter through subsequent amendments or consolidations. The terminus and length of track were noted. With respect to Table 4, the shorter write-ups tended to include the information on characteristics, capital structure, rolling stock, and earnings. In addition, Vernon mentioned the cost of road and equipment. Also given was the distribution of net earnings to interest, rent, dividends, and

street railroads, and railroads known by more than one name), about 30 involved extensive write-ups (two or more pages) for steam railroads. Hence, taking into account the additional items in his manual, Poor had a somewhat higher proportion of longer write-ups than Vernon. On the other hand, exact comparisons were hard to make since Poor's page size was smaller.

surplus. However, not all the information was always presented, presumably because it was not available. In addition, some of the write-ups were written for railroads under construction and those leased to other railroads. In these cases, Vernon briefly discussed progress to date or the lease terms. Often included were connections with other railroads, the express company used (e.g., American Express), a list of directors, and the location of the general office.

An example of a longer write-up is that for the New York Central and Hudson River Railroad. It was five pages with about half of its length devoted to the railroad's long history and consolidations. For the year ended September 30, 1872, Vernon [1873, p. 136] noted a considerable discrepancy between total liabilities (including stock) and the cost of the road and equipment. He stated that:

> It would be better if the items on which the increase in capital stock was originally based were charged to their appropriate heads, and the value of the property on the books made to correspond with the existing liabilities; then a correct balance-sheet could be published from year to year, and there would not be such a glaring discrepancy between assets and liabilities, which must naturally puzzle those who are not conversant with the *legitimate* process by which the capital stock was increased nearly 100 per cent. and the value of the property correctly appraised.

Though stock watering was common, Vernon believed that the liabilities, not the assets, represented the actual value of the track and rolling stock. Notably, Vernon also provided ratios in which the actual cost-per-mile of road and per-mile of track were calculated.

In tables, Vernon reported physical operations for three years (e.g., miles run, passengers in total and carried one mile, tons of freight in total and carried one mile, etc.), "doings" (happenings) in transportation for three years (gross earnings, expenses, and net earnings), and expenses by categories for two years (e.g., office and station expenses, cost of running, etc.). He also reported the ratio of total expenses to gross earnings. In sentence form, he gave the distribution of net earnings to grading and bridging, interest on bonds, dividends, and rent, with the remainder carried forward to the income account for the next year. Vernon discussed other matters, such as the financing of two additional tracks from New York to Buffalo, the leasing of the New York and Harlem Railroad, the replacing of existing rails with steel rails, and the competency of management (i.e., Vanderbilt).

In summary, Vernon [1873] emphasized a railroad's legal organization, including its original charter, amendments, and consolidations. Compared with Poor's [1868] entry on the New York Central, Vernon spent more time on the history of the company and less on providing tables.[18] Operating and financial information was generally limited to the current, or at least the most recent years. In contrast, Poor [1868] provided more operating and financial information covering six years. Vernon's approach may have been sufficient for an annual work. However, based on a search of WorldCat [2008], Vernon only published one more edition of his work in 1874. His manual may have been a victim of the Panic of 1873.

The most popular railroad manual of the era, Poor's *Manual of the Railroads of the United States* was in its 12th edition in 1879.[19] The general index contained over 1,350 entries. Most of these referenced American and Canadian railroads, but also included state debts, city and suburban tramways, the Panama Railroad, Pullman's Palace Car Co., and the United States Rolling Stock Co.[20] In addition, an appendix listed the names of former railways and the name of the current railway of which they were now a part. A classified index and an alphabetical list of advertisers were also provided.[21]

The introduction reiterated the purpose of providing information on railroads: "What the public requires is an accurate presentation of their financial condition" [Poor, 1879, p. 1]. Poor commented that he was better able to fulfill this mission since the railroads and state oversight boards disclosed more information.[22] Yet, with respect to some railroads, "there are

[18] Poor [1860] covered the history of railroads and canals.

[19] Another long-running railroad manual, *The Manual of Statistics* [Financial News Association, 1879], started in 1879. It, like Poor's *Manual*, was published into the 1920s. Unfortunately, no copies of the inaugural edition could be located, either through interlibrary loan or otherwise (no library could be indentified using WorldCat [2008] that actually had the 1879 edition).

[20] As noted, there were approximately 750 entries in the general index to Poor [1868]. As a sign of the times, Poor deleted about a dozen entries for canals that had been in his 1868-1869 *Manual*. In the newer edition, Poor only included canals associated with a railroad.

[21] One notable user of Poor's *Manuals* was Jay Gould. Fowler [1873, p. 563] noted that before the Panic of 1873, Gould "was poring over 'Poor's Railroad Manual' in search of some other good railroad to link on to those that he then held."

[22] Poor was more successful than stockholders in obtaining information for the New York Central which did not provide annual reports to stockholders in the

still a considerable number which either refuse it altogether, or supply it sparingly and grudgingly." He added that, "The refusal of information should, as a rule, be taken as evidence, that, if communicated, it would tell strongly against the company, or persons refusing it."

Poor was optimistic. In 1878, 2,700 miles of track were added, resulting in over 81,000 total miles in the U.S. Poor expected mileage to double as the system reached undeveloped lands and expanded to accommodate growth in population and commerce. Financially, Poor commented that railroad earnings for 1878 were nearly equal to the peak year of 1873, and, despite the ensuing depression, freight tonnage had increased 50%. This boded well for the railroads in the future as they "will start upon a new career, with an ample tonnage traffic, the rates on which are only slightly increased to add enormously to their net earnings." He noted that a large number of railroads had been reorganized "upon a plan, or scheme, to reduce their interest-bearing securities to a sum the interest on which could in all probability by met by the accruing incomes, leaving dividends on common or preferred stock to be paid as earned." Poor [1870, pp. ii, iii] observed optimistically: "With the general recovery witnessed on every hand, and with an enormous balance of trade with foreign countries in our favor, there is every reason to believe that the country, and particularly its Railroads, are entering upon a career of unwonted prosperity."

Next, Poor provided a table for all railroads showing in total, for each of the years 1871 through 1878, miles operated, capital and funded debt, gross earnings broken down by freight and passenger, net earnings, and dividends paid. In the next table, he presented these data regionally, comparing 1877 and 1878 results. Poor also provided mileage, rolling stock, capital, cost, earnings, interest, and dividends, both in total and per 100 miles of railroad for each state..

The main part of the manual, comprising 997 pages, was organized by states and territories within regions. For each state or territory, Poor included the area in square miles, population, and miles of railroad. A table showed for each railroad total mileage, total in the state or territory, cost of railroad per mile, length of railroad worked, gross earnings per mile, expenses as a percent of gross earnings, profits per mile, and percent of dividends paid. The entries for individual railroads in that state

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1870s and 1880s [Previts and Merino, 1998].

followed, ranging in length from about a quarter of a page to several pages. Of the approximately 1,160 entries for railroads, 95 of them were two or more pages.[23]

Illustrative of the longer entries that Poor included is that for the New York Central & Hudson River Railroad. The entry was about five pages long. Poor began the entry by giving the main-line mileage owned; branches; second, third, and fourth tracks; and others, such as sidings, turnouts, and auxiliary. He also listed the mileage of the lines leased from others and the total length of all tracks operated. The gauge of the track was included as well as the types of rails (e.g., steel and weight). Table 5 shows the extensive information provided in the remainder of the entry. Both physical and financial information was included. Especially noteworthy are the breakdowns of classes of freight, gross earnings, expenditures, capital structure, and operating assets. This remarkable amount of information was more detailed than that of Vernon [1873]. Much of it was presented on a comparative basis covering six years. Several ratios on a per-mile basis were reported as well as the percent of expenses to gross earnings (revenues). Overall, 166 of the approximately 1,160 railroad entries (14%) in the manual had some sort of a comparative earnings table. Comparative financial statements (balance sheets) were less common.

The five-page entry for the New York Central in the 1879 *Manual* is comparable, with a few notable changes, to that of the four-page entry in the 1868-1869 *Manual*. The historical write-up was more extended in 1879, giving the charter and opening dates of the various lines. In the 1879 edition, Poor combined tables in the earlier manual on "doings in transportation," earnings, and the income account into his "Comparative Statement of Operations, Traffic, and Revenue." In the process, he eliminated calculations per 100 miles each for freight and passengers, replacing them with per-mile calculations for gross earnings, expenses, and net earnings. He added percent of expenses to gross earnings and the average rates (dollars) per passenger per mile and per ton per mile. Similarly, he combined the information on track mileage (deleting details on second tracks, sidings, etc.), rolling stock, and financial condition into a single "General Account" table. Poor in the 1879 edition only provided details of funded debt for the current year rather than in a table covering six years. He deleted the monthly stock-price table. In

[23] As noted, this compared with only 30 entries of at least two pages in Poor [1868], which was less than half (about 400 pages) of the length of Poor [1879].

the newer edition, he presented more details of expenses and

TABLE 5

Poor's Entry for the New York Central

Rolling Stock – numbers of locomotives and cars by type (e.g., passenger and freight)

Constituent Companies – dates of charter and opening of predecessor companies and leased lines

Operations – miles run by passenger and freight trains, number of passengers and tons of freight in total, per mile, and rates per mile, classes of freight by ton (e.g., forest products, animal and animal products, manufactures, etc.), earnings by source (passengers, freight, mail, etc.,), expenditures (maintenance of way, rolling stock, fuel, etc.), net earnings, other receipts (e.g., rents and interest), other payments (e.g., interest on bonds, dividends, rent), and surplus for year

Comparative Statement of Operations, Traffic, and Revenue for 1872-1878 – miles of railroad and all tracks, passenger and freight miles, passengers carried and passenger miles, freight tons moved and ton miles, gross traffic earnings (passenger, freight, and miscellaneous), transportation expenses, net traffic earnings, other receipts, payments (rentals, interest, dividends), balance to surplus, per mile basis for gross earnings, gross expenses, and net earnings, percentage of gross expenses to gross earnings, average rate per passenger per mile, and average rate per ton per mile

Financial Statement at September 30, 1878 – capital stock account, funded debt, bonds and mortgages on real estate, and total; per contra, grading and masonry, bridges, superstructure, stations and buildings, land and land damages, locomotive engines and snow plows, passenger and baggage cars, freight and other cars, engineering and agencies, investments in other lines, and balance of other assets

Funded debt – issues, interest rates, maturity dates

Comparative General Account at September 30 for 1872-1878 – miles of railroad and tracks, numbers of locomotives and cars, dollar amounts for capital stock account, funded debt, real estate bonds, floating debt, total capital, railroad, equipment, engineering and agencies, investments in other railroads, and balance of other assets

Other – directors, officers, and principal office and address

Source: Poor [1879]

railroad assets for the current year, but with fewer details of other liabilities and other assets.

The shorter entries were typically about a half page or less. Table 6 shows a reproduction of the information for the Parker and Karns City Railroad. The format for a shorter entry was similar to that for the New York Central. The major difference was that only one year's data, with fewer details, were included.

For example, the financial-operations section might only supply gross earnings, operating expenses, and net earnings. The financial-statement section might only include capital stock, funded debt, floating debt, and the assets reported might be limited to the cost of road. Poor usually included details of the funded debt, such as due dates and interest rates. A fair number of the entries were brief when the lines were leased to others. Sometimes, Poor just reported basic description when the railroad refused to provide the information. Some of the shorter entries in the 1879 *Manual* were longer than those in the 1868-1869 edition. The newer entries contained an historical write-up, more gross earnings breakdowns, more balance-sheet amounts, more calculations of rates, and details of the funded debt.

TABLE 6

Poor's Entry for Parker and Karns City Railroad

Line of Road.-Parker Junction, Pa., to Karns City, Pa..............10.50 miles. Sidings and other tracks, 1.31 miles. Gauge, 3 feet. Rail, 30 lbs.

Construction commenced October 1, 1873. Road opened April 10, 1874.

Rolling Stock.-Locomotive engines, 4. Cars-passenger, 5; baggage, etc., 2; Freight (box, 10; and platform, 36), 46-total, 53.

Operations for year ending December 31, 1878.-Gross earnings-passenger $101,459.40; freight, $63,011.64; and miscellaneous, $5,627.83-total ($16,199.89 per mile), $170,098.87. Operating expenses (51.19 p. c.), $87,099.06. Net earnings, $82,999.81. Disposition of net earnings not reported.

Financial Statement, December 31,1878.-Cost of road ($21,547.39 p. m.), $226,247.50, and of equipment ($7,426.72 p. m.), $77,980.54; total, road and equipment ($28,974.12 p. m.), $304,228.11. Capital stock, $150,000. Funded debt, 1st mortgage 7 per cent. gold bonds, $100,000.

S. D. Karns, *President*....................................Parker City, Pa.

PRINCIPAL OFFICE AND ADDRESS.....................Parker City, Pa.

Source: Poor [1879, p. 344]

Compared with Vernon's 1873 *Manual*, Poor's 1879 *Manual* also included a history of the company, but Poor refrained from editorializing on how the company was doing or on the competency of the management. Again, Poor provided more data covering more years, and he included more ratios. Both authors, however, reported the ratio of operating expenses to gross earnings. Poor had more entries as well as more entries with longer write-ups, although this could have been a function of the later publication date. Yet, both authors were frustrated by the lack of information forthcoming from some of the railroads.

On the other hand, these railroad manuals contained considerably more information than mining manuals from the era.[24] One mining manual [Mining Review Publishing Company, 1879] provided an overview of mining stock exchanges, mining laws, mines, biographies, and articles related to mining. Most of the descriptions of the approximately 475 individual mines were less than one-quarter of a page and were often just a few lines. They included basic organizational information (e.g., directors), capital, physical descriptions of the property, and progress to date. In some cases, the descriptions included assessments, dividends, value of ore, costs of mining and milling per ton, expected profits, and law suits and other disputes with adjoining mines. No financial statements were reported.

In summary, while investors sometimes had a wealth of information for some railroads, for others it was sparse and hard to come by. Moreover, the comparability of the expense/asset amounts troubled Vernon. In contrast, Poor was not overly concerned about the reliability of the data. He believed that this potential problem was mitigated by presenting comparative information over several years. He thought that this approach made it more difficult for the railroads to hide something [Chandler, 1956].

A SYNTHESIS AND CONCLUSION

Did outside investors from the 1870s need financial accounting information? Clearly, Medbery [1870] and Sullivan [1876] thought that the answer was yes. They thought that financial-accounting information, especially earnings information, was necessary to make informed decisions. The *NYT* agreed. In the wake of the Panic of 1873, it was proposed that NYSE railroads provide monthly financial statements. The financial statement would have included earnings (revenues) and expenses and should have resulted in "more confidence felt by investors in their purchases, which are now mostly made blindfolded, as it were" [*NYT*, 1873f, p. 1].

Due to inside information, railroad directors had an unfair

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[24] Mining securities were not traded on the NYSE. Most of them were traded on the New York Mining Stock Exchange, the San Francisco Stock and Exchange Board, the Pacific Stock Exchange, or the California Stock and Exchange Board [Mining Review Publishing Company, 1879].

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advantage over outside stockholders. The suggested solution was the disclosure by railroads of weekly earnings (revenues) and monthly statements of earnings and expenses [*HMM*, 1870a]. Additionally, there was support for inspection, on demand, of a railroad's books by stockholders [*HMM*, 1870e].

Was financial accounting information available? Painstaking effort was made to provide this information, especially by periodicals and railroad manuals. Available information to aid investment decisions expanded and became more timely as exemplified by the merger of the popular monthly *HMM* with the weekly *Commercial and Financial Chronicle*. By the end of the 1870s, the merged *Chronicle*, the most prominent financial periodical of its time, provided a host of data. Earnings information was reported along with basic security descriptors, price, volume, economic, and money-market data. The *ARJ* presented even more operational, balance-sheet, and earnings data for railroads.

Yet, the most detailed operational and financial information was provided in railroad manuals, especially Poor's. Poor [1879] reported more information about more railroads. In a growing number of cases, he included six years of comparative physical asset, operational, earnings, and balance-sheet numbers. In addition, sophistication of the analysis of the information grew as Poor presented more ratios involving per-mile calculations. Both he and Vernon [1873] calculated a railroad's ratio of operating expenses to gross earnings. These ratios should have helped investors better understand railroads. They are key metrics that Cramer [2005] insists are critical to understanding an industry.

Unfortunately, some railroads still refused or disclosed relatively little information. Further, Poor [1879] reported comparative earnings information for only about one in seven railroads. Balance-sheet information was reported for even fewer. State regulatory agencies that promoted financial disclosure, such as the Massachusetts Board of Railroad Commissioners, were in their infancy in the 1870s [McCraw, 1984]. At the federal level, it would not be until 1887 that the Interstate Commerce Commission required standardized formats for financial statements, and it would not be until 1906 that the Hepburn Act required standardized accounting methods [Baskin and Miranti, 1997]. Moreover, having all publicly held companies routinely providing financial accounting information was still more than half a century away. Outsiders would have to wait for a systematic reporting process while they contended with railroad kings and sweeping economic events like the Panic of 1873.

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ACCOUNTING HISTORY REVIEW CONFERENCE

at Cardiff University, 12th-13th September 2011

ANNOUNCEMENT AND CALL FOR PAPERS

The 23rd accounting history conference organised at Cardiff Business School will be the launch event for *Accounting History Review*. In accordance with the focus of the journal a key theme of the conference will be 'Accounting in History' - exploring the scope for greater interdisciplinary engagement between accounting and mainstream historians. The guest speakers are historians whose work has important implications for accounting history research. Plenary addresses will be given by Mary Poovey, New York University, author of *Genres of the Credit Economy: Mediating Value in Eighteenth and Nineteenth-Century Britain* and *A History of the Modern Fact*; and Evan Jones, Bristol University, author of prize winning work on accounting for smuggling in the mid-sixteenth century.

Also with a view to stimulating the development of new research agendas there will be a panel discussion on future research directions in accounting history involving leading commentators on the state of the field over the past two decades. Panellists include Salvador Carmona, Warwick Funnell, Christopher Napier and Stephen Walker.

The conference will also feature parallel sessions. Theoretical, empirical and review papers are welcomed in all areas of accounting history.

Delegates are provided with the opportunity of receiving constructive feedback, in an informal setting, on papers ranging from early working drafts to fully developed manuscripts. The programme allows approximately 35 minutes for presentation and discussion.

The conference, organised by Malcolm Anderson and Stephen Walker, will be held in the prestigious Glamorgan Building of Cardiff University. Sessions will commence on the morning of 12th September 2011 and conclude in the late afternoon of 13th September.

The event will feature a wine reception sponsored by Taylor & Francis on 11th September, conference lunches, teas and a dinner in the Great Hall of Caerphilly Castle, one of the most impressive medieval fortresses in western Europe. A link to local hotel and university accommodation booking can be found on the conference website www.cf.ac.uk/carbs/conferences/ahr2011/index.html.

Those wishing to offer papers to be considered for presentation at the conference should send a *one page abstract* (including name, affiliation and contact details) formatted in Word as an email attachment by *1st June 2011* to Carbs-Conference@cf.ac.uk. Tel +44 (0)29 2087 5731. Applicants will be advised of the conference organisers' decision by 10th June 2011.

Part of the costs of this conference are being paid by the ICAEW's charitable trusts. These trusts support educational projects relating to accountancy and economics.

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2010 VANGERMEERSCH AWARD WINNER

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"I Ask the Profession to Stand Still": The Evolution of American Public Accountancy, 1927-1962

Abstract: This paper traces the emergence of the AICPA as an effective national representative of the American profession. Central to this evolution was a broadening of the Institute's outlook to encompass all practicing CPAs and to embrace the benefits of public relations and lobbying. The paper begins with the Wall Street elite that dominated the Institute's predecessor, the AIA, and describes the pressures for reform that culminated in the Securities Acts of 1933 and 1934 and set this evolution in motion. The final section makes use of former AICPA president Marquis Eaton's papers to show how pressure from the Securities and Exchange Commission, from competing professions, and from a geometric increase in the profession's numbers brought a more pragmatic and aggresive leadership to the Institute, one that more closely resembles the modern AICPA.

INTRODUCTION

Studies of the U.S. accounting profession's development often end with the 1930s, viewing the New Deal, the unification of the profession in 1936, and the McKesson & Robbins (M&R) scandal of 1939 as the seminal events in the profession's history [Miranti, 1990; Sriram and Vollmers, 1997]. Few emphasize the importance of the next two decades and the realignment of the profession's leadership and goals took place. This paper focuses on the crucial years of 1927-1962, when accountants evolved from an insular, divided group with an uncertain mandate from American society for its services to a profession eager to promote itself and to expand its reach and responsibilities. From

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the beginning of the push to reform U.S. capital markets with William Z. Ripley's 1927 polemic *Main Street and Wall Street* to the M&R audit scandal, the leadership of the profession remained aloof from the opinions of those outside the profession. But in the wake of the Securities Acts of 1933 and 1934 and M&R, a new generation of leaders began to take a more expansive view of the profession's proper role. Faced with pressure from the Securities and Exchange Commission (SEC), from competing professions, and from a geometric increase in the profession's numbers, a more pragmatic group took the reins of accounting's national leadership, embodied in the AIA, and began to embrace the benefits of public relations and lobbying. They were motivated not only by their own vision of a greater public profile as an essential part of a true profession but by the inroads competing professions were making into CPAs' hard-won jurisdictions in financial-statement audits, taxes, and the burgeoning field of management-advisory services. This led them to a more aggressive and self-interested stance for the profession, eagerly seeking out new venues and new revenue for CPAs' skills. Beginning with the union corruption scandals of the 1950s and the promotion of the CPA's abilities as "business advisors" in 1962 testimony before Congress by incoming AICPA president Robert Witschey, the AICPA's increasingly aggressive lobbying efforts on behalf of its members showed how far the profession's evolution had taken it.

This paper retraces the profession's path through the seismic shocks of the Great Depression, the New Deal, and M&R and evaluates the role these events played in shifting the profession's leadership away from the aristocratic traditions of the Wall Street-centered elite and towards a more pragmatic generation more in sync with the unique public-private regulatory model the New Dealers envisioned for the profession. Particular attention is paid to the efforts of John Carey, a non-accountant who, as executive director of the AIA and the AICPA, became the profession's cheerleader everywhere from his editorial column in the *Journal of Accountancy* to the halls of Congress and state legislatures; to Marquis Eaton, who laid the groundwork for the profession's new public-relations efforts and presided over the name change that finally, after 20 years of resistance from the profession's old guard, made the AICPA the official representative of CPAs; and to Carman Blough who, as the first chief accountant of the SEC and later as director of research for the AICPA, probably did more to improve the quality of financial reporting in the U.S. than any other individual in accounting's history.

The best known and most colorful of the older generation, George O. May of Price Waterhouse & Co., also figures prominently in this paper. May's career is in many ways the best vehicle from which to describe the evolution of the American profession. He personified the old-world model of the gentleman professional, confident that his professional expertise made his integrity clear to outsiders and largely obviated the need for formal regulation. This model proved incompatible with Progressive notions of legal standards of conduct for market actors, and May's influence steadily waned after the 1930s. Accounting's next generation of leaders better understood the demands that a nation with an historic aversion to government oversight placed on professions. This generation (slowly) implemented more uniform accounting and auditing principles and procedures and accepted responsibility for the quality of work of all CPAs. But in navigating the course laid out for them, the AICPA found itself defending more and more professional territory, expanding into new fields, and fighting off challenges from competing professions that threatened its members' practices. Soon this dialectic had made the CPA a businessman more than a disinterested professional, and May was one of the few voices lamenting that the ideal his generation had strived for had been left behind. The portrayal of May is meant to help illustrate the tension at the heart of this story, that while much of the paper would certainly qualify as a Whig interpretation of history, this evolution is what ultimately led to the profession becoming more self-interested. The professionalization of accounting, in short, is what caused the damage to the profession's credibility.

This paper is in the style of traditional narrative history, employing archival sources to offer a portrait of the U.S. profession in the mid-20th century. The first half of the paper describes the profession under the leadership of the national accounting firms, referred to throughout as the Wall Street elite because of its clientele's listing on the New York Stock Exchange (NYSE). The papers of James M. Landis and George O. May, combined with practitioner journals, mainstream media sources, and an abundant secondary literature on the New Deal (perhaps the only era of the U.S. profession to have received thorough, critical evaluation by multiple historians) are the bases for these sections. The heart of the paper are the years beginning in 1939, years that previous historians have largely framed around the development of accounting principles [see Zeff, 1971, 2003; Chatov, 1975; Previts and Merino, 1998]. But this was only one aspect, and as will be argued, not the most important in the profession's evolution over the two decades following the M&R scandal. The papers of former AICPA president Eaton have been available at the University of Florida since the 1970s, but as far as the author can determine have never been used. These memos and letters provide a wealth of information on how and why the AICPA became just another "trade organization" that aided accounting firms in "serving their own business interests" at the expense of the investing public [Turner, 2006, p. 392].

The story in this paper fits neatly into the existing paradigms of the professionalization literature. Accounting historians have made use of Abbott's jurisdiction model (see below) and Macdonald and Ritzer's dilemma of exclusiveness vs. market control[1] to describe the growth of public accountancy in several nations [e.g., Carnegie *et al*. 2003; Walker, 2004; Edwards *et al*. 2005]. The U.S. offers its own iteration. In the 1920s, the profession was divided into two national factions along lines of practice (national firms auditing big business with local practices providing basic accounting services) and background (northeasterners strongly influenced by British practice vs. southerners and midwesterners often of non-Anglo-Saxon descent). This schism left the profession without an authoritative voice and the two groups merged in 1936 expressly to lay claim to representing the entire profession. In the postwar era, an expanding economy created opportunities for other professions to challenge CPAs' jurisdictions in audit, tax, and management consulting. But by this time, a united profession, led by an aggressive leadership, could successfully defend the CPAs' territory.

THE AIA ELITE AND THE SECURITIES ACTS

Writing of the American legal profession in the early 20th century, Galambos [1983, p. 488] describes "a profession virtually controlled by a WASP elite, which used its power and status to ward off threats from liberal reformers and the country's new immigrants." A similar picture emerges in the accounting profession of the 1920s. Accounting's dominant voices were national firms such as Price, Waterhouse & Co., headquartered in New York and conducting financial-statement audits for the largest American corporations. Until the M&R scandal, this Wall

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[1] Macdonald and Ritzer [1988, pp. 257-258] write "…to control the market, the occupational body must include anyone with a reasonable claim to expertise, but such inclusion brings in marginal practitioners who lower the standing of higher-status practitioners."

Street elite served as the profession's national voice.

These men formed the leadership of the AIA, which like the AICPA was a voluntary organization (In the U.S., licensing of CPAs is reserved to the individual states.). Until 1921, the AIA served as the only national organization of public accountants. Many of its leaders were British chartered accountants sent to the U.S. to develop an American presence for their firms. In 1926, one-fifth of the AIA's membership consisted of accountants born outside the U.S. [see Nissley, 1928, p. 37]. They tended to favor an apprenticeship system similar to their own training, rather than the more egalitarian college education prevalent in the U.S. In many cases, they were also reluctant to associate with men of southern and eastern European heritages [Miranti, 1990, p. 123]. Most importantly, they did not respect the CPA certificate, which they dismissed as a state-regulated license that conferred legitimacy on an inferior class of accountants. In 1919, the AIA had attempted to secure legislation in Congress that would recognize its membership as superior to a CPA license. As late as 1926, the AIA refused to limit its future membership to CPAs [Springer, 1936a, p. 749]. This finally led to the creation of a rival national organization, the American Society of Certified Public Accountants (ASCPA), in 1921. This is the most conspicuous example of the AIA's failure to exercise leadership for the profession. At a time when it could have taken all CPAs under its wing and embraced responsibility for raising the professional standards of all public accountants in the U.S., the AIA instead chose to distance itself from the rest of the profession.

Many small town CPAs in the 1920s may also have found it difficult to relate to the AIA's official periodical, the *Journal of Accountancy*, particularly to the style of its editor, A.P. Richardson. Durand Springer, founder of the ASCPA, reportedly "could not stomach the leisurely ways of the elite who in those days dominated the Institute's activities…Heading that elite group was A.P. Richardson, a nonaccountant and an import who has often been referred to as the epitome of a perfect English gentleman"[2] [Kohler, 1975, p. 27]. After stepping down as editor in 1936 (to be replaced by John Carey), Richardson [1040. p. 217] returned to the *Journal* in 1939 with a regular column titled "This Blessed Language" of which the following passage is rep-

[2] "Perfect English gentleman" was apparently a style Richardson affected. Alphyon Perry Richardson was born and raised in New Jersey, never attended college, and worked as a reporter for the *Wall Street Journal* [O'Neill, 1980, p. 1].

resentative:

> Take…the quotation: 'Only the brave deserves the fair';…as the sentence stands it means of course that the brave man and no one else deserves the fair. If we say 'The only brave deserves the fair,' we may mean that an Indian warrior is deserving or that there is no more than one brave man.'The brave only deserves the fair' probably means that our hero deserves the fair but is not to have her. Now, moving our wandering adverb another step forward, we say 'The brave deserves only the fair' and we imply that the brave man deserves nothing except the fair. Again 'The brave deserves the only fair.' Here we find that the choice is limited. If there be other ladies present they do not qualify. And, finally, if we say 'The brave deserves the fair only,' I don't know exactly what it means.

The AIA's inadequacy as a leadership organization became particularly apparent in the crisis years that followed the stock market crash of 1929. Pressure had been building on the profession since the publication of economics professor William Z. Ripley's *Main Street and Wall Street* in 1927, which brought the issue of financial reporting to the attention of a broader public. His portrayal of auditors as too-closely tied to their corporate clients and lacking authoritative standards for financial reporting brought unwanted attention to the profession [Richardson, 1927a, p. 254; Kohler, 1933b, p. 142]. But the AIA leadership was reluctant to take action. It was George O. May, senior partner at Price, Waterhouse & Co., who saw the handwriting on the wall for reform and led the first effort to improve the quality of financial reporting. As early as 1926, May [1936, pp. 44, 46] warned: "There is not in the profession as it now exists a body of men capable of dealing adequately with the problem…at the present time auditors hold office usually at the pleasure of the officers of the company." Ripley's writings spurred May to take the initiative in reforming financial accounting practices [May Papers, 57-6; AICPA, 1960]. May would write: "It is becoming recognized that if the interests of all affected by corporate development – and that includes a large proportion of our people – are to be protected, it is vitally important that some basic principles of accounting should be established and given substantially the force of law" [May Papers 53-6, September 11, 1930]. May's efforts led to the NYSE requiring annual financial statement audits for all listed firms in 1932 and to the publication of *Audits of Corporate Accounts* (1934), at the time the most comprehensive effort to establish accounting principles.

By this time, in no small part due to the revelations of the Pecora hearings in Congress, May had lost the initiative and federal legislation became inevitable [Seligman, 1982, p. 2; Flesher and Flesher, 1986, p. 421]. Inexplicably, though, the profession was caught by surprise by the 1933 Securities Act, passed during President Roosevelt's "Hundred Days" with the goal of restoring confidence in U.S.capital markets. "Despite William Z. Ripley, despite Berle and Means, despite the Pecora investigation, despite public demand for reform of the securities markets, the Institute had made no effective preparation to deal with legislation directed to that end" [Carey, 1969, p. 182]. The obloquy even came from the accounting academe. Eric Kohler [1933a, p. 164], editor of *The Accounting Review*, railed against "the inherent snobbishness in many of the Institute's published reports – a snobbishness and lack of good taste that have their origin in a real ignorance of the things at stake in the accounting profession. There is no indication of any understanding of the problems that lie ahead; no appreciation of the newer opportunities for the profession in the bloodless social revolution in which we have been immersed during the past year." After the passage of the 1933 act, the profession quickly realized its importance, and both the AIA and ASCPA sent representatives to Washington to help write the detailed regulations to implement the law [Landis papers, Folder 2-3; Chatov, 1975, p. 56; Zeff, 2008, p. 177].

Without a unified voice, accountants had been unable to exercise any real influence on the 1933 act. Colonel Arthur Carter of the New York State Society (NYSSCPA), apparently on his own initiative, did testify at the congressional hearings leading up the 1933 act, though it is interesting to note that he reportedly did so as a gesture of U.S. accountants' independence from the British-dominated AIA [Carey, 1979, p. 34]. The impact of Carter's testimony is unclear; contemporary newspaper coverage suggests it was quickly forgotten [*New York Times* (*NYT*), April 2, 1933, p. 1; *Wall Street Journal*, April 3, 1933, p. 8; see also Wiesen, 1978]. One reason may have been Carter's imperious tone:

> Sen. Barkley: You audit the controllers?
>
> Col. Carter: Yes, the public accountant audits the controller's account.
>
> Sen. Barkley: Who audits you?
>
> Col. Carter: Our conscience.

The pompous spirit of much of the AIA alienated not only the vast majority of U.S. CPAs (most of whom did not belong to either the AIA or the ASCPA) but also the New Dealers who wrote the Securities Acts. James Landis, the chief author of the Securities Acts and later chairman of the SEC, summed up the profession this way in 1936: "The impact of almost daily tilts with accountants, some of them called leaders in their profession, often leaves little doubt that their loyalties to management are stronger than their sense of responsibility to the investor" [Carey, 1979, p. 36]. Landis particularly had in mind May, who had worked closely with Landis in the months after the 1933 act and who had garnered a reputation as the profession's "philosopher" [Carey, 1970, p. 3]. Born in England in 1873, May was extremely well educated despite never having attended college, instead rising up through an apprecticeship to join Price, Waterhouse & Co. in London [Grady, 1962, pp. 9-13; Parker, 2010, p. 5]. In 1896, he was sent by the British firm to conduct audits in the U.S. and was one of the founders of the U.S. profession. Landis [1959, p. 35, fn. 12] felt such antipathy towards May that a quarter century after the Securities Acts, he found space in a 20-page law journal article to single him out for criticism: "Despite the fact now generally recognized that the registration requirements of the Securities Act have introduced into the accounting profession ethical and professional standards comparable to those of other recognized professions, the then dean of the accounting profession, George O. May of Price, Waterhouse & Co. was strangely opposed to our proposed requirements for independent accountants." And Landis was not the only one. William Paton [1981, pp. 91-94], professor of accounting at the University of Michigan and one of the leading accounting theorists of his generation, remembers May as "a very conceited Englishman, and hypersensitive to criticism, even when somewhat justified…his brusque way of disposing of questions he didn't like, and his rather domineering attitude toward all those daring to ask questions, annoyed both faculty and students…I understand that I was one of only three people who dared to call him 'George.'" More significantly, Landis' opinion of May seems to have extended to the entire profession. He wrote to Felix Frankfurter: "I was up the night before and talked to some accountants…a very strange class of people whom I suppose by the very nature of their profession are without any humor" [Parrish, 1970, p. 200]. The feeling was apparently mutual. Carey [1979, p. 35] would remember: "Mr. Landis was not so easy to deal with. Cordial and conciliatory at first, he became increasingly critical of the accounting profession. He was a thin, tense, somewhat impatient man, almost humorless, and clearly feeling the pressure of his new responsibilities."

The 1934 Securities Exchange Act, passed by Congress and signed by Roosevelt on June 6, 1934, created the SEC and granted it power to regulate Wall Street, including the accountants who audited publicly traded companies. It might have been expected that without the trappings of a true profession (one organization representing all practicing accountants, clear independence from their corporate clients, an established lobbying presence in Washington), the SEC would not have trusted the profession to handle such an essential cog in U.S. capital markets as big business' financial communications to the public. But such was not the case. Despite the SEC's lack of confidence in accountants, the profession was largely left to govern itself, putting in place a regulatory regime that has since been the object of almost constant criticism from Congress, the media, and historians [U.S. Congress, 1976; Previts and Merino 1998, pp. 271, 318; Zeff, 2003, pp. 195-196]. As an historian of the Securities Acts concluded: "Nothing jarred the SEC's confidence in the accounting profession's ability to evolve more uniform terminology and techniques. Commissioners and staff members merely became impatient" [Parrish, 1970, p. 206]. By 1939, Landis had concluded: "As long as you have the May leadership in the accounting situation, I have very little hope of seeing them accomplish much" [quoted in Parrish, 1970, p. 206].

THE SECURITIES ACTS' IMPACT ON THE PROFESSION

The passage of the Securities Acts was the single most important event in the professionalization of accounting; they legitimized the profession by granting it an exclusive franchise to conduct financial-statement audits, providing auditors with the leverage to resist the demands of their corporate clients. They imposed clear accountability with liability standards for negligence. As dicussed below, they spurred the unification of the profession in 1936. And there was near universal agreement among contemporaries that they improved the quality of financial reporting by encouraging the development of more uniform accounting principles [*Certified Public Accountant,* 1933, p. 597; Smith, 1937, p. 152; Cooper and Ijiri, 1979, p. 36]. Finally, the acts enshrined a regulatory framework that, regardless of its effectiveness, has presided over the most successful capital market in the history of the world.

The experience of the Securities Acts did spur the consolidation of the AIA and ASCPA in 1936. Hostility between the two groups, based not only on differences in clientele and scale but on class and ethnicity, had at times reached puerile levels. From 1927 to 1932, the respective journals of the two organizations, the *Journal of Accountancy* and *The Certified Public Accountant*, rarely even mentioned the name of its rival. Robert Montgomery [1939a, p. 38], of the national firm Lybrand, Ross Bros. & Montgomery, noted: "The profession had been greatly handicapped in its contacts with governmental agencies in Washington, due to the inability of the representatives of the two societies to represent the interests of the profession as a whole." But even with this in mind, acrimony nearly destroyed the union. As Montgomery [1939b, p. 72] remembered it: "The retiring [AIA] president was bitterly opposed to the merger. For some obscure and wholly unfounded reason, he argued that the AIA would be diluted in quality and reduced in prestige by the proposed merger." Members of the ASCPA pointedly noted that it was not a "merger" at all. Even at this late date, the AIA refused the ASCPA's proposal that the two organizations combine into a new organization to be called "The American Institute of Certified Public Accountants." Instead, the ASCPA was "absorbed" into the AIA despite the fact that less than 3% of the AIA's members by 1936 were non-CPAs [Springer, 1936b]. It would take two more decades of fighting before the AIA explicitly became the national organization of CPAs, and then only in response to the encroachments of unlicensed public accountants.

Carman Blough's role in the profession's leadership began in these years. Having worked his way up through the ranks of state government in Wisconsin, Blough probably had more in common with the ASCPA than the AIA elite [Miranti, 1990, p. 153]. While working at the Wisconsin State Board of Public Affairs, he met George Mathews, a future SEC commissioner, and, in 1934, he joined the SEC as a financial analyst. By 1935, the SEC decided a need existed for a "final arbitrator in all accounting problems facing the Commission," and Blough was appointed the first chief accountant of the SEC [Cooper, 1982, pp. xviii, 8]. Carey remembered that "there could not have been a more fortunate appointment…tempermentally he was ideally suited for the new job…He was open minded, willing to listen" [Cooper, 1982, p. xiv].

But while a more affable presence than James Landis, Blough was a stern advocate for more formalized accounting principles. He told the NYSSCPA in 1937:

> Almost daily, principles that for years I had thought were definitely accepted among the members of the profession are violated in a registration statement prepared by some accountant in whom I have high confidence. Indeed, an examination of hundreds of statements filed with our Commission almost leads one to the conclusion that aside from the simple rules of double entry bookkeeping, there are very few principles of accounting upon which the accountants of this country are in agreement [Carey, 1970, p. 10].

Carey [1970. p. 11] remembered: "The cumulative effect of this speech was devastating." Blough would later add: "Unless the profession took steps to reduce the areas of difference in accounting practices the Commission would" [quoted in Zeff, 1972, p. 132]. It was Blough's hope that the profession would accept the challenge: "I have emphasized at numerous times that the policy of the Securities and Exchange Commission was to encourage the accountants to develop uniformity of procedure themselves, in which case we would follow" [AIA, 1937, p.190]. He certainly had his work cut out for him in persuading the Wall Street elite to embrace formalized rules at the expense of professional discretion. As a Lybrand, Ross Bros. partner protested, "There is the idea that standardized accounting is a simple matter, that the only reason it has not advanced further is to be found in the ignorance or dishonesty of accountants and the management of large industries" [Warren, 1934, p. 10]. The SEC received some support for its efforts from accounting academics when their organization, the American Accounting Association, issued "A Tentative Statement of Accounting Principles Affecting Corporate Reports" in 1936 [Carey, 1970, pp. 11-12]. Blough and others at the SEC sedulously pursued improved accounting principles until the M&R scandal undermined the old guard's claim to leadership of the profession.

HOW M&R AND WORLD WAR II CHANGED THE PROFESSION

The reforms of the New Deal, although initially intended to bring fundamental change to accounting, had little impact on the profession over the course of the 1930s. The Wall Street elite remained firmly entrenched in the profession's leadership, much to the consternation of accounting's new overseers at the SEC. And however superannuated this elite may have become, it clung defiantly to the professional model that had seen it through the decade's crises. In his valedictory address to the AIA in 1937, outgoing President Montgomery encouraged his audience to continue whistling past the graveyard: "We have been told so often that we cannot remain still, we must go forward or backward, that we are inclined to believe it. Nevertheless, I ask the profession to stand still. I do not want it to change" [AIA, 1937, pp. 89-90].

The forces driving public accountancy to become the profession the New Dealers envisioned would work slowly over the next two decades. The unification of the profession into one national organization in 1936 was the first step towards broadening the leadership's outlook to embrace CPAs throughout the U.S. But it was the M&R scandal and the demands that World War II placed on accounting that undermined the old-guard leadership of the AIA and paved the way for U.S. public accountancy's next generation of leaders.

The M&R scandal was uncovered in December 1938. From 1923 to 1937, auditors from Price, Waterhouse & Co. had been accepting fraudulent inventory and accounts receivable records prepared by a convicted felon operating under an assumed name [*NYT*, December 24, 1938, p. 4, January 13, 1939, p. 38]. The revelation that systematic fraud had been perpetrated under the nose of the profession's premier firm made headlines in newspapers all over the country and led to major changes in audit procedures. It also proved a major blow to the elite generation's control of the profession, both to its prestige and to its numbers, as the practice of relying on temporary workers came under greater scrutiny and the ranks of full-time CPAs swelled. It occurred just as the AIA was beginning to take steps towards the establishment of accounting principles, short-circuiting the elite's efforts to placate the SEC [Previts and Robinson, 1996, p. 69]. In September 1938, the AIA's Committee on Accounting Procedure (CAP) had recommended that it be given additional responsibilities and personnel, "recognizing the existence of a widespread demand for greater uniformity" [Carey, 1970, p. 12]. The CAP's work continued after the scandal as it issued 51 Accounting Research Bulletins by 1959, to be succeeded by the Accounting Principles Board.

The lurid events of the fraud brought the profession unprecedented public scrutiny. Within a month of the revelation of the scandal, the attorney general of New York summoned leaders of the AIA to his office to discuss what reforms were needed, and his office issued a statement that "the Coster-Musica [M&R] case [has] revealed certain fundamental weaknesses in the preparation of financial statements of large corporations" (*NYT*, December 24, 1938, p. 4]. The new chairman of the SEC, Jerome Frank, hoped the fallout from M&R would mark "a turning point in accounting standards" and called on accountants to take the lessons of the scandal to heart and begin to accept the responsibilities the New Dealers had laid out for them six years before: "Without in any way indicating what the applicable law and morals may have been in the past, I suggest that the McKesson & Robbins case…raises, for the future, certain questions with respect to corporations whose securities are listed or registered. While the controller serves not only the management but also the stockholders, should not the accountant serve the management and the stockholders and the bondholders and other creditors? And should not the accountant serve not merely the existing stockholders and bondholders, but all future investors" [*NYT*, January 9, 1939, p. 45]?

The profession showed a new sensitivity to public relations by responding quickly to the crisis. By May 1939, six months after the scandal broke, new procedures were put in place that required physical checking of inventory and confirmation of receivables. A new tone could be detected in response to the SEC's investigation into the scandal:

> Such an investigation might not be proper in the case of any other profession, but certified public accountants recognize a dual responsibility which is unique – a responsibility to the client and a responsibility to the public which may rely upon the accountant's report. It was no doubt in the belief that the investing public, as represented by the S.E.C., had a right to know all it wanted to know about generally accepted auditing procedure that the accounting profession cooperated fully in providing the desired information [Carey, 1941, p. 1].

The new audit procedures, as well as the SEC's issuance of Accounting Series Release (ASR) No. 4, requiring for the first time "substantial authoritative support" for an accounting principle, helped to end the rules vs. judgment debate that had marked the profession's generational fault lines: "The significance of McKesson, in combination with ASR 4…was to complete the transformation of an accounting professional's discretionary roles from individual-laissez-faire driven judgments regarding principles and procedures, to a judgmental process directed by peer professional standards, guided by a committee structure of the AIA" [Previts and Robinson, 1996, p. 76].

Besides making many in the profession more aware of the power of public opinion, M&R offered an opening to the smaller firms that desired a greater say in the profession. At a meeting with members of New York Governor Lehman's staff, as the *NYT* [January 9, 1939, p. 11] reported:

> A number of [speakers] charged that about 90 per cent of all the brokerage and investment firms, as well as the greatest industrial firms listed on the Stock and Curb Exchanges, were audited by six or seven great firms of which Price, Waterhouse, and Co., auditors of the McKesson & Robbins Company, was one. With this was coupled a charge that the officials of these firms dominated the New York State Society of Certified Public Accountants and the American Institute of Accountants which resulted in a too lenient interpretation by the Association of principles which should be applied to all accountancy activity. Speakers declared that where small accounting firms, auditing smaller business houses, made it an almost invariable practice to check on statements of inventories and of accounts receivable before listing them in audit, the larger accounting firms, dealing with the books and records of the larger houses, in general accepted the statements of officers of the companies audited and put them into balance sheets without further checks.

The scandal offered those outside the profession's leadership the opportunity to voice long-simmering resentments of the big-firm elite. Clem Collins, who had served as president of the AIA from 1937-1939, observed: "Ever since the matter [M&R] came up, which is about three years ago, there have been numerous criticisms. When I was president, I received a great many letters insinuating that there was not full consideration being given, and that because this firm [Price, Waterhouse] was a large firm, perhaps they were not subjected to as severe examination and censure as might be accorded to a smaller firm" [Carey, 1970, p. 40].

Coming so quickly on the heels of M&R, U.S. entry into World War II saw a perhaps chastened profession respond with alacrity to the demands of a wartime economy. As the *NYT* [November 10, 1942, p. 41] told its readers: "Recognizing that accounting has become an indispensable element in war production and in control of the government's vast expenditures, the executive committee of the American Institute of Accountants yesterday announced adoption of a war activities program to remain in effect for the duration." As quickly as January 1942, practitioner journals were advising their readers of the new issues their clients would be facing, from contingencies in the face of uncertain payment from government funds to questions as to whether "accounting reports may be of value to enemy forces," and whether subsidiaries of clients now in enemy hands could still be listed as assets on their balance sheets [Towns, 1942a, p. 270].

The war's effects on U.S. public accountancy would not be felt until the post-war era, but their importance should not be overlooked. The domestic labor shortages brought large numbers of new entrants into the profession. Most prominently, this included women, although in the 1950s, many firms returned to their pre-war hiring practices, and women lost many of the gains they had achieved in accounting [Wootton and Kemmerer, 2000, p. 175]. In addition, the war greatly expanded the need for tax services. Taxes before the war had affected a maximum of 6% of the population [Zelizer, 1998, p. 84]. Increased rates of personal income taxation as well as wartime excess profits taxes added to the complexity and scope of the tax code and gave birth to a swelling of the ranks of tax accountants that would continue in the post-war era as tax rates remained high [Towns, 1942a, p. 374; Perry, 1944, p. 139].

The war also saw tremendous advances in the field of management-advisory services. The unprecedented scale of war contracts led to innovations in business management and recordkeeping. "There is no doubt but that WPB and OPA have forced many businesses to develop more adequate records" ["War Has Changed Old Bookkeeping," 1944, p. 273]. To implement machine recordkeeping such as punch-card systems, the large accounting firms were often brought in as consultants [Higgens, 1965, p. 188]. As Perry [1944. p. 139] summarized it:

> Prior to the war, the average accounting practice was largely composed of audit work and preparation of tax returns, sweetened on occasion by nonrecurring system engagements or cases dealing with new financing.The scope of services rendered by accountants has been considerably extended in wartime, and it seems probable that the success of the profession in handling these varied assignments may result in a wider field of practice in the future.The problems of business management have been tremendously complicated by the network of wartime controls in the face of expanding volume, and shortage of managerial manpower has led many clients to turn to professional accountants for assistance.

The dilemma created for the profession by consulting ser-

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vices will be subsequently discussed.

THE POST-WAR PROFESSION

The end of the war found the profession stronger than ever, with a younger, more modern generation at the helm. Accounting's impressive contributions to the war effort had enhanced the profession's image: "Many of [our] members occupied high places in the armed forces; others served with distinction in an advisory capacity. Washington came to know the accounting profession better than ever before, and today recognizes the value of services which professional accountants render to the government" [Carey, 1946, p. 1]. The lessons of M&R provided momentum to the two campaigns that marked the sharpest break from the 1920s generation. The drive for improved accounting principles, interrupted by the war, resumed in earnest [Zeff, 2001], and a new respect for the necessity of public relations became central to the profession's agenda. The combination of new leadership that embraced the demands post-war America placed on them, an expansion of the profession's numbers that reoriented the national leadership away from the big national firms, and the challenges accounting faced from competing professions led to a new AIA (soon to become the AICPA) that played a pivotal role in molding the profession that exists today.

The AIA's determination to take all CPAs under its wing, a process begun with the consolidation in 1936, meant new priorities to meet the needs of its membership: "The influx of veterans and post-World War II CPAs into the profession…[brought] a new and much larger generation, more diverse in practice" [Previts, 1985, p. 84]. Firms like Price, Waterhouse & Co. had traditionally limited their partnership ranks to a select few, but the increase in the scale and scope of accounting work in the 1950s forced it to welcome partners from southern and eastern European backgrounds as well as many younger CPAs more amenable to the changing times [Allen and McDermott, 1993, pp. 93, 115].

Perhaps the most important change resulting from the AIA's expanded membership was a reorientation to the priorities of small firms. The AIA's focus in the post-war era turned away from the increasingly independent national firms and towards the needs of small practitioners. While the national firms expanded to smaller markets and to the international stage, smaller firms were growing at an even faster rate: "From 1946 to 1966 the number of CPA's associated with the ten largest firms had jumped from 2,950 to 11,850 – a 401% increase. However, the total number of CPA's had jumped from 20,778 to 94,284 during the same period – a 453% increase" [Carey, 1970, p. 356]. Small accounting firms increasingly faced challenges requiring an authoritative and representative voice as an ever-expanding set of accounting rules, as well as increased automation and cost-tracking techniques, placed more demands on CPAs.

Carman Blough remained on the front lines of this battle, becoming director of research for the AIA in 1944. He would continue to prod accountants to adopt more uniform procedures for audits and financial-statement preparation as he had done in the 1930s as chief accountant of the SEC [Carey, 1970, p. 156]. He did this with speeches and a regular column in the *Journal of Accountancy*, "Current Accounting and Auditing Problems," in which he clarified technical accounting issues and encouraged the use of best practices, geared particularly to the needs of small practitioners.

Carey had taken over as editor of the *Journal of Accountancy* in 1937, and he was named executive director of the AIA in 1948. The contrast with the old Wall Street elite, particularly his predecessor as editor of the *Journal,* A.P. Richardson, could not have been more pronounced. Richardson's flowery, verbose editorials, so incongruous in the pages of a technical practitioner's journal, gave way to a modest, business-like style. Carey [1954, p. 33] encouraged a sense of pride and challenged members to embrace the "social responsibilities of CPAs" and constantly congratulated them on their progress:

> Such rapid growth might have resulted in disorganization…on the contrary, professional organization has improved…A vast amount of work remains to be done before the CPA will be universally accepted as the equal of his colleagues in the older professions, [but] for the first time, it seems to us, it may be said that the rough framework at least [now exists]…to complete the structure of the accounting profession.

Carey regularly crisscrossed the U.S., testifying before state legislatures and speaking before state and local CPA societies. He wrote *Professional Ethics of Public Accounting*, hailed as a "masterpiece," to placate the SEC's demands that accountants formalize their rules on auditor independence ["'Tis Not the Whole of Auditing," 1947, p. 3], and more than anyone else, Carey [1949, pp. 3, 5] pressed the need for a greater public profile for the profession:

> When certified public accountants were a small, comparatively obscure group, regarded as technical experts who could help management and credit grantors in their work, nobody else bothered very much about the accounting profession. But now, when auditing, measurement of profit, cost determination, and tax problems are recognized as matters of vital importance, not only to management and credit grantors, but investors, labor unions, consumers, economists, analysts, statisticians, lawyers, government policy makers, and others, the accounting profession suddenly finds itself in a goldfish bowl…we can't escape the basic truth that public opinion will largely determine the accounting profession's opportunity for future progress…[in response] the Institute has developed a comprehensive public relations program.

For the most part, CPAs supported Carey's efforts. State societies supplemented his work with their own public-relations campaigns ["President's Report – 1947-8," *The Texas Accountant,* 1948, Vol. 21, No. 7, p. 9; "Public Relations Program for 1951-2," *The Texas Accountant,* 1951, Vol. 24, No. 10, p. 6]. Future AIA president Marquis Eaton recognized Carey's service to the profession in effusive terms:

> In my opinion it would be impossible for the Institute to do too much in acknowledgement of [Carey's] contribution to the profession…[He] is eligible for retirement in twelve years.That date is not so far off that we can postpose any longer our preparation for it…I have often heard the question, who are we going to get to take John Carey's place? We should get that question out of our thinking. We are not going to get anybody to take his place" [Eaton letter , May 5, 1950, group 9, box 3, F.14; Eaton speech, October 27, 1956, G12, B2, F28, University of Florida Papers].

The AIA's new focus did not win universal acclaim in the accounting community. May, now in his third decade of retirement, maintained a vigorous and often cantankerous correspondence with Institute officials. "I deeply regret the appointment of an expert in publicity as editor of the *Journal of Accountancy*," May [May Papers, 58-10, 1956] wrote to Blough. "It seems to me to be an acceptance of the view that the function of that Journal is to promote the interests of accountants rather than to give accountants professional guidance." To John Inglis of Price, Waterhouse & Co., he continued: "I think it is high time somebody protested against Carey's monopolistic rule in the Institute" [May papers, 58-10, 1956]. Nor was May reluctant to share his views face-to-face, as the normally unflappable Carey [Group 9, B.10, F.73, June 29, 1956, University of Florida Papers] related to Eaton: "I enclose excerpts from some notes Mr. May gave me when he took me to lunch to criticize my article in the May, 1956 *Journal*. I am omitting some of the notes of a personal nature."

THE AICPA TURNS TO LOBBYING

A desire to burnish the CPA's image in the public mind was not based solely on an idealistic vision of what a true profession should be. Blough, Carey, Eaton, and others were cornered into action by the encroachments of competing professions. As lawyers, management consultants, and unlicensed public accountants aggressively pursued new venues for their services, the AIA felt compelled to push back, reluctantly forced to expand the CPA's field of competence and to promote itself in the power corridors of Washington.

Andrew Abbott [1988, p. 2] described jurisdictions (interprofessional competition) as "a fundamental fact of professional life." It is through competition with other professions that a profession carves out its professional space. "Control of knowledge and its application means dominating outsiders who attack that control…the professions make up an interdependent system. In this system, each profession has its activities under various kinds of jurisdiction…boundaries are perpetually in dispute." U.S. public accountancy embraced the trappings of a modern profession – ppublic relations, lobbying, responsibility for all members of the profession – in response to the efforts of its competitors.

The most pressing jurisdictional challenge from the 1920s through the 1950s came from unlicensed public accountants (PA). In the post-war era, CPAs were generally college graduates who had passed a now nationally standardized and notoriously rigorous examination process [Merino, 2006, p. 369]. PAs competed only in local markets and so posed little threat to the Big Eight firms. But for small practitioner CPAs, unlicensed PAs were interlopers who threatened their status and thwarted goals of professional unity. The AIA's official policy was to encourage PAs to obtain the educational and statutory requirements of CPAs, something the PAs, not surprisingly, resisted as pointless, bureaucratic hoop-jumping [Tinsley, 1983, p. 29]. Although PAs had their own state and nationwide organizations, anyone could call himself a public accountant. CPAs major concern was that unethical or untrained individuals holding themselves out as PAs would damage the reputation of the accounting profession. In the 1920s, state CPA societies pursued regulatory or "two-class" legislation which would license non-certified PAs then practicing and prohibit future registration, thus making PAs a "dying class." In another example of the AIA's aloofness from the needs of small practitioners in this era, the AIA officially opposed such legislation, hindering the state societies' efforts [Tinsley, 1962, pp. 34-35].

The national firms did have substantive reasons for their opposition. In several states, regulatory legislation allowed only accountants registered in the state to certify financial statements. This proved a serious inconvenience to the national firms attempting to serve clients with offices scattered around the country. Second, several state-court decisions had questioned the constiutionality of regulatory legislation, suggesting that it "deprived [PAs] of the fruits of [their] training" [G9, b4, f23, April 18, 1946, University of Florida Archives]. Finally, as has been noted, the AIA in the 1920s still had a significant number of British chartered accountants who were not CPAs, and so would be classified with the inferior class of PAs under regulatory legislation {Richardson, 1933c, p. 248]. Most likely, this issue explains why the Securities Acts allowed for audits of publicly traded companies to be conducted by CPAs or PAs.

In the post-war era, with the AIA's new focus on the concerns of small practitioners, the PA movement became one of its most pressing issues. In 1945, spurred partly by the influx of returning veterans and because the demand for accounting services far outpaced the number of CPAs, the National Society of Public Accountants {NSPA) was formed and commenced lobbying state legislatures and the Bureau of Internal Revenue (later the Internal Revenue Service) to recognize non-certified PAs as equal in status and qualifications to CPAs [Texas Society of CPAs, 1946, p. 5]. Some PAs even pressed to abolish the CPA designation altogether [Tinsley, 1962, p. 68]. The NSPA apparently made considerable headway in gaining credibility for its members in Congress. In 1957, the AIA learned, the Joint Committee on Internal Revenue Taxation inquired of the NSPA "soliciting suggestions for improvements in individual tax forms 1040 and 1040A. The AIA was not asked to assist in this study. "[The Joint Committee] apparently felt that our members would not be as well informed about individual tax returns as the public accountants. Efforts have already been made to disabuse them of this idea" [G9, B5,F32, memo, "Activities of the NSPA," October 9, 1957, University of Florida Archives].

It was specifically in response to the challenge from the NSPA that the AIA finally chose to rid itself of the last vestige of the old Wall Street elite and change its name to the AICPA [AICPA, 1957, p. 1]. This had been a contentious issue in 1936, even threatening to scuttle the consolidation. As Carey remembered: "In 1936, the question of what the name of the surviving organization should be was naturally charged with emotion and loyalties…the membership defeated the proposal [to adopt the name AICPA]. There was some bitterness among those who favored it" [G9, b5, f26, January 20, 1955, University of Florida Archives]. The change was opposed because some members felt that the name AIA had aquired a prestige in business and political circles. But there was another more dubious justification that suggests the arrogance and inflexibility of the old AIA: "The American Institute of Accountants is a more euphonious term than is the American Institute of Certified Public Accountants… the proposed name is longer, will not make as neat looking a letterhead and in general it will be cumbersome" [Springer, 1936, p. 632]. Over the course of the next 20 years, remnants of the old guard as well as inertia kept the AIA from changing its name, even though "on numerous occassions, members have suggested that the change of the AIA's name would be very helpful to them in associating the title Certified Public Accountants with the Institute's many excellent publications and public relations activities. Some members have shown difficulty in understanding why the Institute should persist in its present title" [G9, b5, f26, January 20, 1955, University of Florida Archives]. But it was only in March 1954 that the *Journal of Accountancy's* subheading became: "Published monthly by the American Institute of Accountants, the national professional society of certified public accountants." Finally, in 1957, the AIA became the AICPA. Eaton considered this one of his crowning achievements as president of the Institute [G9, B15, Dcember 26, 1956, University of Florida Archives].

While initially a small-practitioner concern, the PA movement eventually redounded to the national firms as well. In the early days of the income tax in the 1910s, the legal profession spurned tax work and left the field to accountants [Carey, 1949, p. 3; Chatov, 1975, p. 42]. As the complexity and ubiquity of taxes grew, however, the ranks of tax lawyers expanded, leading to a long-running battle with the accounting profession. The growth of the PA movement seemed to damage the prestige of CPAs, as the NSPA began lobbying Congress to allow PAs to represent their clients before the Treasury Department [G9, B5, F32, May 8, 1957, University of Florida Archives]. The AIA was deeply alarmed by this development, fearing that lawyers and legislators tended to lump all accountants together [G9, B5, F26, "Comment on Dean Griswold's Speech," 1957, University of Florida Archives; G9, B4, F23, December 12, 1955, University of Florida Archives]. These fears came to a head with the *Agran* case in 1954, which briefly threatened to restrict the right of CPAs to represent clients before the Treasury Department [Carey, 1970, p. 240].

It was the AIA's fears of the inroads made by PAs and lawyers that persuaded it to take a more active role in lobbying. It began keeping close tabs on the Washington activities of the PAs: "The National Society of Public Accountants [NSPA] has recently acquired some powerful friends in its drive to extract greater recognition from the Treasury" [G9, b5, F32, October 9, 1958, University of Florida Archives]. In 1955, the AIA began establishing stronger contacts with key congressmen and cabinet departments with the help of a public relations and lobbying firm to supplement the efforts of Covington & Burling, the law firm that had represented the AIA in Washington since the 1920s [G9, b4, F23, December 5. 1955, University of Florida Archives].

The AIA also established a Washington office for the first time since the 1930s. The ASCPA, although not the AIA, had maintained an office in Washington for years, and initially the office was to be maintained as part of the new organization. But although many thought it important to have a presence in Washington, the office was closed in 1937. The AIA determined that "adequate information and advice regarding legislation and departmental regulations, and introductions, when necessary, to Governmental officials, have always been readily obtained through counsel to the Institute, who are situated in Washington…the volume of activity does not appear to justify the cost of maintaining the office" ["Closing of Washington Office," 1937, p. 27; see also Montgomery, 1936, p. 329].

The office was reopened by the AICPA in 1959, but only with great reluctance. Carey cautioned: "The Institute cannot overlook how its actions may affect its public relations. If it behaves like a trade union, quarreling over a monopolistic privelege, it will attract little support and perhaps contempt and ridicule. This is particularly important in view of present relations with the legal profession. If on the other hand it acts like a leader, shows no desire to punish its opponents or to oppress a weaker group of people, it may get the credit for a statesmanlike approach to a problem which is of real interest to the public" [G9, b4, f23, December 1, 1955, University of Florida Archives]. Carey [1970, p. 436] would also note in his official history that the new office "gave the Institute a visibility in the nation's capital which had not existed before," although he insists "the charge to the Washington staff was not to lobby."

The AIA's response to the union corruption scandals showcased its new determination to make its presence felt in the nation's capital. In 1955, a special Senate subcommittee, known as the McClellan Committee after its chair, John McClellan, began hearings investigating corruption in trade unions. These hearings, best remembered today for the exchanges between Senate counsel Robert Kennedy and frequent witness Jimmy Hoffa, exposed intimidation, violence, and corruption in the handling of union funds. The hearings showed that a lack of proper financial controls played a role in the corruption – bookkeeping was erratic or nonexistent, union funds were embezzled by bosses, and fraudulent financial statements were presented to the rank-and-file [Doron, 2009, p. 221]. Among the proposals to clean up the unions was a requirement for annual financial-statement audits. The NSPA sent its president, Raymond Jennison, to testify before Congress on the skills that public accountants could offer, and the AICPA felt obliged to send its own representative to advocate an expansion of the audit franchise for the first time since the New Deal. Blough, as director of research for the AICPA, testified before Congress in 1957 and again in 1959, articulating the profession's reticence:

> The Institute is not a frequent witness before Congress…It has been the policy of our institute up until last year not to make this type of representation before Congress on the basis that, if we appeared on bills of this kind, it would be taken that we were self-serving in our appearance, that the purpose we had in mind was to get more work for CPAs. For that reason, we were very reluctant, for years, to make any presentations of this type. But about a year ago our executive committee reached the conclusion that this was not a sound policy, that where fiscal matters were involved on which we should have specialized knowledge, we should make ourselves available for questioning and should make representations, as I have here today, on matters in

which we feel we have particular abilities [U.S. Congress, 1959, pp. 979, 985].

While the old Wall Street elite would surely have shunned the idea of involving themselves with trade unions, by 1957, the AICPA felt it could not afford to concede any ground to the NSPA. As a result, it offered the services of CPAs to unions that often had poor financial controls, thereby risking huge new liabilities if any fraud were to occur on its watch. Perhaps at no other time in the profession's history has it made such a generous offer in the name of public service, although its motives were considerably more complex.

By 1962, the AICPA's attitude towards active lobbying had undergone a virtual transformation. At a hearing on the needs of small business, Robert Witschey, nominee for president of the AICPA, eagerly promoted the CPA as business advisor: "The traditional functions of the certified public accountant have been the independent auditing of financial statements leading to the expression of an opinion as to their fairness, and consultation on tax problems. After World War II, however, it became apparent that one of the most important needs of small-business management was assistance in areas where the training and experience of CPA's gave them special skills." Witschey further relates a study that found CPAs were the most sought-after outside consultants among small business manufacturers [U.S. Congress, 1962, pp. 113-114]. Gone are Blough's qualifiers about the AICPA not wanting to appear self-serving.

THE PROFESSION AND MANAGEMENT-ADVISORY SERVICES

The growth in the complexity of business, particularly the increasing reliance on electronic data-processing technology, helped to fuel the market for consulting services after the war. For the most part, the profession welcomed the opportunity to expand its scope of service, hoping "to improve the prestige of the CPA as an advisor to management, and to increase the reliance of the business community upon the CPA" [Frisbee, 1957, p. 29]. In no small part, the AIA's embrace of this field stemmed from its new focus on the needs of small practitioners. National firms were developing MAS departments independently of the AIA, and the concerns about maintaining independence when performing both audit and non-audit services to a client did not apply to small practitioners whose clients generally were not publicly traded corporations.

Nonetheless, concerns about the impact of MAS on firms large and small were raised even in these early years. Many feared that the CPA was extending himself into areas beyond his competence, and some echoed the cautionary from May that the "noble obligation" of the independent auditor could be jeopardized "as a result of this expanding service to management" ["A Talk With George O. May," 1956, p. 42; on competence, see "Management Services by CPAs," 1957, p. 42]. Some also noted more inter-firm competition in the rush to obtain MAS clients [Alvin Jennings memo, G9,b10, f77, December 27, 1956, University of Florida Archives].

But what drove the expansion into the MAS field were the demands of the post-war era. Eaton observed that "many clients ask for consulting help, [and] are disappointed when the CPA cannot or will not provide it" [G9, b7, f40, University of Florida Archives]. This fueled the profession's greatest fear regarding MAS; namely, that competing professions would take the work if CPAs did not move quickly to establish themselves: "We must give more attention to improving this type of service lest the day come when we find ourselves doing the hard work of digging out and analyzing complex financial facts only to find management consultants and others providing the advice, representation, and management aids based on those facts" [Witschey, G9, b3, F16, 1956, University of Florida Archives; see also "Management Services," 1946, p. 5]. Finally, CPAs' work in the MAS field touched on the campaign to end reliance on temporary workers as firms hoped to find more year-round work for staff by securing consulting engagements [Previts, 1985, p. 80].

CONCLUSIONS

Public accountancy in the U.S. modernized and professionalized in the mid-20th century as a result of several forces – government regulation, unwanted publicity from the M&R scandal, the demands of World War II, pressure from competing professions, and, not least, by the vision of several leaders who pushed and prodded U.S. accountancy to meet the demands these forces placed upon it. This evolution was not without its consequences for the profession. A new business model was created for U.S. public accountancy in the 1950s, one that aggressively and effectively wielded power in the nation's capital. The AICPA "and its generally ferocious lobbyists" became "accustomed to getting its way in Washington" [Spinner, 2002, p. E1; Stone, 2002, p. 793]. In 1973, proposals in Congress to expand auditors' independence and to create stronger audit committees failed when the AICPA weighed in with assurances that self-regulation remained effective [Turner, 2006, p. 383]. Over the next three decades, the profession continued to fight restrictions on accounting firms' expanding scope of services, particularly MAS work, and "in 2000, the accounting industry's potent lobby trained its big guns on Securities & Exchange Commission Chairman Arthur Levitt Jr. – and blew him out of the water." When they continued this strategy after the Enron and WorldCom scandals, "the hard-line strategy backfired," and the profession was shut out of the negotiations that led to the Sarbanes-Oxley Act of 2002, which "effectively ended" the profession's self-regulation [Henry and McNamee, 2003, p. 56, Glover *et. al.*, 2009, p. 222]. As George May had warned, the AICPA had become an advocate for its members rather than an arbiter of accounting practice.

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INTERFACES

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From Mellmott to Madoff: History in the (Re) Making

"History" has never enjoyed a peaceful existence. There has been a constant struggle over the primacy of ideas. The tacit agenda of mainstream history is often to elevate the version of the victors and to defend the status quo. A few years ago, doctoral students attending an American Accounting Association (AAA) colloquium were informed by an eminent, tenured professor that nothing in *The Accounting Review* (*TAR*) older than five years was worth reading.[1]

Editors of *TAR* and the *Journal of Accounting Research* (*JAR*) did not always express such distain for past scholarship. *JAR* was a joint creation of the University of Chicago and the London School of Economics (LSE). The latter was dominated by historians such as Will Baxter and Harold Edey. Their graduate disciples came to dominate chair appointments in the U.K. and beyond. Most notable were Peter Bird, Sir Brian Carsberg, David Solomons, Robert Parker, Geoffrey Harcourt, and Tony Lowe.

While archivalism/empiricism typified the research focus of the LSE's "Godfather-Originals" (Edey and Baxter), their first-generation students diversified into quite eclectic directions (managerial economics [Sir Brian Carsberg]; managerial economics, philosophy, general systems theory, and cybernetics [Tony Lowe]; and, *inter alia*, income theory and economics [Robert Parker]).

The transition from history to market studies proceeded at different speeds in JAR and TAR. TAR, a "public society" journal, was slower to embrace market studies and abandon history.

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[1] We challenge any reader to recall the titles and authors of the first article of the first 2005 issue of *TAR*.

However, 1965 marked a turning point in bringing TAR to heel. Pressure from the then Big Eight accounting firms and their clients forced the editor of TAR to tell Abraham Briloff "never to submit his work to TAR again" [Tinker and Puxty, 1995]. Briloff was the bête noire of the Big Eight and their clients.[2]

The capitulation of TAR to market forces was accomplished directly and indirectly. Directly, the AAA became increasingly dependent on non-membership fees as a source of revenue [Tinker, 2001]. Indirectly, the Big Eight and their clients colonized the professoriate with funding of chairs and research. This gave a "chosen few" an elevated status and access to research finance and, therefore, publications. This "edge" allowed market-friendly professors access to positions of influence via publications, editorial-board memberships, and executive-committee appointments at the AAA [Williams, 1980, 1985].

The rush to "market" was a lot easier for a private journal like JAR under the tutelage of its editor, Nicholas Dopuch. Dopuch was based at the (private) University of Chicago that openly courts market sources of funding from the Big Eight, their clients, and anyone else willing to pay. Private sources are the lifeblood of private universities.

Dopuch had no qualms about dumping JAR's connection with the LSE's quaint history and adopting a new research order of pseudo-scientific rigor of regression-based market studies. As shown later, this self-declared brand of positivism and empiricism in accounting is philosophically naïve [Tinker *et al.*, 1982; Christenson, 1983].

Importantly, for historians who might lament the demise of accounting history, as Marx pointed some 160 years earlier, the struggle for ideas was no longer an intellectual contest about the merits of ideas, but had been replaced by "prizefighters" [Marx, 1977, afterword]. For Marx, from around 1850 onward, the market was beginning to assimilate "political economy."

Changes in the accounting realm were accompanied by parallel movements elsewhere in the university. In the U.S, the Cyert Report elevated the business school MBA as the premier qualification for populating the upper echelons of America's corporate management.[3] In the U.K, there were no indigenous busi-

[2] Briloff promptly switched to *Barron's* to continue his critique of the Big Eight and their corporate clients. With a much larger circulation than any academic journal, *TAR*'s rejection was a blessing in disguise.

[3] The insertion of "business" into the U.S. university campus was not accepted without reservation. To this day, Harvard University only allows the Harvard Business School to award a DBA, not a Ph.D.

ness schools of consequence; economics departments typically controlled any business and accounting curricula. Accordingly, the U.K. government provided seed-money of £30 million to establish the Manchester and London Business Schools. These were the bellwethers for others to follow. One consequence of this growing commodification of U.K. education was the eclipse of economic history, epitomized by the decline of history at the LSE which has been replaced there as a training ground for the sons and daughters of the rich and famous around the globe.[4]

History, philosophy, and "the classics" no longer appear on the usual business doctoral curriculum. Aristotle, Plato, and Socrates are dead and buried. These, and their fellow texts, have been displaced by "modern math" that has erected its own hermeneutically sealed, home-spun standards of "relevance," "truth," "validity," etc. Mainstream market studies routinely report R-squares, often of minuscule explanatory size, as "confirmation" that their hypotheses have not been rejected and, therefore by implication, remain "true."

These tests are nicely isolated from the established standards of epistemic appraisal [Whitley, 1972, 1973, 1986]. Even Karl Popper [1957], a conservative philosopher of note, demonstrates that any brand of empiricism/positivism that seeks to "confirm" an hypothesis is not tenable from a philosophical perspective. In his *Logic of Scientific Discovery*, Popper argues that the empirical finding of one black swan (analogous for us to a failed bank with a particular leverage ratio) does not allow a researcher to conclude that all swans are black (or that all banks with a particular leverage ratio are doomed). Inference to a truth statement is a fallacious philosophy.[5]

Market-studies confirmationalists perpetrate tests that are akin to trying to affirm/confirm that finding one purple swan reinforces the dogma that all swans might be purple. This has the convenient ideological purpose of affirming the status quo, including the tacit thesis of market studies. The monotonous re-use of regression studies with familiar market variables tacitly affirms that the market is equilibrating and therefore working well in providing a proper allocation of society's resources and

[4] Seventy % of LSE students are now from wealthy overseas families. The LSE is now the intellectual West Point (Sandhurst) of the U.K., training the next generation of an indigenous elite that is friendly to the West.

[5] For Popper, researchers should frame their hypothesis for refutation and strive to refute the thesis with evidence. So, for instance, a hypothesis framed that there are no purple swans that is refuted by the discovery of a purple swan allows the researcher to conclude definitively that the hypothesis is refuted.

functions best without regulatory interference.

Confirmationism serves mainstream accountants by protecting the reigning dogma (market studies). As long as the contention that markets are "okay," there is no need to consider "inferior" literatures (history) that can be dismissed as "not *de rigueur*." Dissident research is censored because it might supplant the mainstream sovereign thesis and provide the tools for unearthing "disturbing truths" that would trouble the status quo.

The so-called top three journals, JAR, JAE, and TAR, all play the same jingle, expressed in their own allegorical form and delivering the same message with resounding consistency that markets are "good" because they are efficient and are the best adjudicators for promoting the social good (with the corollary that state interference and regulation are "bad"). What is minimized and excluded by this sovereign position [Ryan, 1982] are contrary viewpoints, those expressed in public interest, taxation, interest, gender issues, history, management accounting, etc. [Whitley, 1972, 1973, 1986; Tinker, 2001].

In the mid-19th century, Marx produced his opus Capital [Vol. 1, 1977]. Adverse to the popular ideology, Capital is not a eulogy to Communism, living socialism, or any other version of "Mickey-Marxism" [Tinker, 1999]. These were self-serving appropriations by dictators and mass murderers who, according to modern historians, never actually read Capital.

Fortunately, there is a change of heart regarding the literatures (including history) that are relevant to deciphering the present. Desperate times call for desperate measures, and in the intellectual realm, this means accepting the unacceptable. And if the *New York Times* issues an edit, it is worthy of attention:

> The financial meltdown has sent the literary-minded scurrying back to the classics for insight and succor. The dastardly exploits of the Ponzi artist Bernie Madoff call to mind *The Last Tycoon* (Fitzgerald and Wilson, 1941) or *The Way We Live Now* (Anthony Trollope, 1941). At a time when hard-core free-marketeers like Richard Posner (2009) are questioning the efficacy of capitalism, the works of Karl Marx are being fished out of the dustbin of history. Most classic critiques of capitalism are much-mentioned but little read, the sort of books people routinely cite without really knowing what's in them [Daniel Gross, 2009].

Anthony Trollope wrote *The Way We Live Now* in the 1850s. His anti-hero, Augustus Melmotte, pre-dated Ponzi by 80 years and Madoff by over 150 years. If scholars and regulators had read Trollope, Madoff might have been on their radar screens and many other con-artists who preceded him.

Melmotte's scam was far more outlandish than Madoff's operation; indeed, by comparison, Madoff's operation appears quite amateurish. Madoff preyed on Jewish philanthropic organizations, the Jewish communities in New York, and the snowbirds who flock to Palm Beach to escape the northeast winter.

Melmotte entered London society with a dubious pedigree. He was a foreigner with a murky past who left Paris under the shadow of a financial scandal. On his arrival in London, Melmotte underwent a complete makeover, burying all traces of his past dossier and weaving his magic by playing on the greed of the English landed gentry. Many of the latter were under financial distress because the primary source of their wealth, agriculture, was in the doldrums because of the influx of cheap corn imports as a result of the Corn Laws.[6]

The landed gentry were desperate for new opportunities to rectify their deteriorating financial condition. Melmotte appeared on the London scene like a knight in shining armor. Like Madoff, he promised gullible investors spectacular returns. Melmotte used the promise of undreamt riches from a railroad venture connecting the U.S. to Mexico. Of course, unbeknownst to the investors, not a line of rail track was ever laid. Instead, investor monies were used to create an aura of matchless success.

Melmotte took care to assuage any doubts about the integrity of his activities by displaying all the trappings of success, providing comfort and reassurance to all those who had unwittingly bankrolled his venture. Madoff used his wealth to secure gold-brick credentials. He built a new mansion in the center of London, unparalleled in splendor and extravagance. He spared no expense on the furnishing. He invited London's upper-crust to a banquet celebrating the opening of his new mansion, starring the Emperor of China. He financed a coming-out ball for his daughter to launch her into English society and to introduce her to eligible marital suitors. Finally, Melmotte used "other peoples' money" to bankroll a successful run for a seat in Parliament. Melmotte was "gold" and Londoners flocked to share in his success.

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[6] The Corn Laws were a legislative coup for the emergent industrial classes who were seeking cheaper costs, including labor costs that included the cost of food used to reproduce their labor force. The wealth of the landed classes was seriously impaired as a result of the Corn Laws.

Like Madoff, Melmotte's pack of cards collapsed with problems of liquidity. He was required to honor a promissory note that he had issued in exchange for title to the mansion that he had renovated and occupied. Melmotte had funds to cover the obligation, but he had transferred his entire fortune out of the reach of his creditors into a safe-harbor of his daughter. The latter had been abused by Melmotte for years and avenged herself by denying her father access to the funds in his time of need. In 18th century parlance, Melmotte did not have "the readies" and was not able to meet the call on the note. He was destroyed by a liquidity crisis and shortly afterwards committed suicide with poison, a more spectacular exit than the ignominious departure by Madoff.

Like Trollope (Melmotte), Marx is also recommended reading by Daniel Gross. Gross [2009] cautions that texts like Capital (and we might add, Keynes's General Theory [1936]) are "…much-mentioned but little read…routinely cited without really knowing what's in them."

At this point, Trollope and Marx part company. Trollope was the victim of "historical forgetfulness"; Marx, however, was the victim of "historical revisionism." Marx, in western literature, was never even "much-mentioned" because during the Cold War, Marx and Marxism were taboo. The mere mention of Marx was to risk the wrath of McCarthyism.

In the U.S.S.R., Marx was "much mentioned and routinely cited" by Stalin, Mao, Poll-Pot, and other mass murders. They shared with western historians the bad habit of never actually having read the original. Indeed, in the U.S.S.R., leading Marxist economists and high-school students only read received texts, usually simplistic renditions commissioned by Joe Stalin. It was Stalin's contention that since the U.S.S.R. had transcended capitalism and had inaugurated "living socialism," Marxism was no longer relevant. Marx's primary text, Capital, the analysis of capitalism was no longer pertinent to the U.S.S.R.

Like Trollope, Marx's Capital speaks eloquently about our present predicament. Contrary to popular belief, Marx's Capital, Volume 1, is neither a diatribe against capitalism nor a celebration of Communism. As Ernest Mandel [1975] notes in his introduction, "…the fundamental aim was to lay bare the laws of motion which govern the origins, the rise, the development, the decline and the disappearance of…the capitalism mode of production….It is…an analysis of the Anatomy of Capitalism" [Marx, 1977, p. 12].

How does Capital address today's world-wide malaise? Marx begins with capitalism's elemental or cellular form, the commodity. The "commodity" for Marx is not just the commonsense notion of a thing that is bought and sold; its most important variant is the labor commodity. Marx's commodity possesses inherent contradictions and, therefore, inherent instabilities. This is not just the vulgar or simplistic notion that labor is "exploited" (which, of course, is correct), but much more importantly, the market quest for surplus value (profit) frequently stands in opposition to the socially valuable aspect of a commodity (its use value). This contradictory feature is the source of social eruptions.

Instances of the opposition are legion; e.g., U.S. healthcare for profit; banking for profit, and education for sale. Another example is Enron's cutting off electricity supplies in California, nicely timed blackouts in the height of summer, to blackmail California into accepting punishing price increases. Enron also pulled the same stunt on 29 third-world (vulnerable and easily corruptible) countries. Enron hijacked the water, electricity, and gas supplies of these countries, using contracts established, sanctioned, and enforced with the blessing of the IMF, which then aided and abetted the compelling of punitive price increases.[7] The West Virginia mining disaster "pit" costs against safety. Exxon Valdez and BP's Deepwater Horizon oil spill exposed the tension between fuel needs and safety/nature/livelihoods. Finally, there is the case of the pollution of Paris' public-water supply that stampeded citizens into purchasing (privately owned) bottled water.

While American and some European workers cower at threats of redundancy and off-shoring their jobs, there is under-reported labor unrest in China, Greece, Spain, and other regions of the globe. The inherent instabilities of the labor commodity are on the rise in different parts of the world.[8] Like Trollope, the lessons from Marx's analysis are as pertinent today as they were

[7] There were street riots protesting the increases in some countries. Enron police assisted in putting down the riots and a number of protestors died.

[8] The U.S. Administration was slow to grasp the significance of the financial instabilities in the euro-zone to protect U.S. interests. Eighty % of IMF capital is financed by the U.S., and the IMF was a major partner in imposing an austerity package in the Greek rescue. Spain, Portugal, and Ireland are waiting in line. Street rioters in Greece openly branded the U.S. for the austerity deal. American banks came a close second as the institutional villains who had precipitated the crisis. To add a further systematic risk complication to the mix, the Greek banks owed nearly $100 billion to German and French banks (The German-led rescue was not entirely altruistic.).

in 1860.

Marx's opus is a careful analysis of Capital(ism). Developing from our earlier work [Neimark and Tinker, 1987], we show that Marx [1977, 1992] and his modern-day "students," notably Theodore Adorno, cited extensively in the original 1977 text, has, like Anthony Trollope, a great deal to say about the present crises [Ryan, 1982; Dews, 1986].

First and foremost, both Marx and Adorno argue that capitalism's crises cannot be resolved or cured; they can only be postponed, deferred, or transformed. This is because the underlying contradictions of capitalism remain undisturbed, so that the deep-rooted antinomies remain ever-present [Gamble and Walton, 1976].

Before proceeding, it is important how much we can take from Marx directly and how much we must draw on those who use his mode of analysis. Marx wrote at a time when European nations were still predominantly agrarian economies with a growing migration of labor from country to town. The industrial bourgeoisie was still an emergent class. There were no monopolies on today's scale.

Notwithstanding the temporal limitations of Marx's Capital, Vol. 1, his legacy is a mode of analysis that endures and allows contemporary Marxists to deploy in examining the present. For instance, his identification of surplus value (profit and taxes) as an expropriation from "productive" activity is expressed today in the generation of massive quantities of surplus values by corporations and the state. Modern-day analysis focuses on where the surpluses (profits and taxes) are deployed [Sweezy and Baron, 1966; Mandel, 1975]. For Mandel, for instance, the military has become the primary recipient of the surplus-value largesse, thereby creating a new "department" in the economy and offering an analysis not too remote from Eisenhower's 1961 warning about the Military-Industrial Complex. More recent studies concentrate on the speculative destabilizing movements engendered by the surpluses extracted by the banking sector, used to pump-and-dump entire stock markets [Cooper, 2008; Balakrishnan, 2009].

We begin by reviewing four contradictory dimensions of the present crisis. Each positions the issues using the classics (Marx and Marxists) and extends the discussion to the present crisis. The four dimensions are the realization crisis, the concentration of capital, the centralization of capital, and the misalignment between identity and non-identity.

THE FOUR DIMENSIONS

The Realization Crisis: "Pump-and-Dump," "bubble-blowing," and "bubble-bursting" are not phrases invented by the "loony-left" but are deployed by contemporary economic commentators when pondering the state of the world-wide economic crisis [Krugman, 2009; Posner, 2009]. Their meditations focus on bubble-blowing by banks and, more recently, bubble-blowing by nation states and their multiple stimulus packages [Tinker, 1992; Sy and Tinker, 2009]. What these analysts fail to ask is why bubble-blowing was such a vital and necessary part of the modern capitalist enterprise?[9] The answer is to be found in the forbidden texts.

Competitive capitalism strives for greater profit, either through socially destructive speculation or by seeking ever greater efficiency by producing "more-with-less" [Allen, 1975; Shaw, 1975; Gamble and Walton, 1976; Braverman, 1998]. "More-with-less" means shedding labor. To avoid adding to the masses of unemployed, capitalism must absorb the discarded laborers, either by finding them gainful employment (economic growth is the prime candidate as long as this can be sustained by "bubble-blowing") or by absorbing surplus labor by using public-sector employment (the U.S. Postal Service, the military, etc.) [Mandel, 1975; Gamble and Walton, 1976; Braverman, 1998].

The problem with the second solution is that it has a finite limit. The U.S. Postal Service is seriously overstaffed, and further expenditures would inflame congressional fears of a new inflationary crisis, instigated by government deficit spending that would earn the wrath of the bond market.[10] Nor is military spending a sustainable option. Drone and other labor-saving technologies reduce the required number of military person-

[9] Alan Greenspan opined as such in his testimony before Congress where he ridiculed members for their hypocritical change of heart. When the bubble was swelling, he was their darling and had their undying support. When the bubble burst, they turned on him like a pack of wolves. Senator Dodd of Connecticut, where all the bank and insurance lobby money resides, performed a spectacular somersault on these issues.

[10] Inflation increases the rates that the bond market must pay on new issues. Bonds issued prior to the inflation period will fall in value to give returns commensurate with the new market rates. Bondholders of those portfolios would suffer major losses. Accordingly, the bond market, four times larger than the market of stocks and shares, hates inflation and lobbies heavily against deficit spending [Cooper, 2008].

nel for absorbing surplus labor. As public disquiet about the death-toll of wars in Iraq and Afghanistan rises, there is growing pressure to replace "men with machines" [Mandel, 1975; Braverman, 1998].

We are also hitting the wall for the first option on the list – inflating demand with credit or bubble-blowing. Maynard Keynes is dead! Anyone who has read The General Theory [Keynes, 1936] would know that Keynes only advised using a stimulus in the nadir of a depression (never preemptively) and that a Keynesian stimulus only works in a semi-closed economy. Today's economies have extensive import-export relations, thereby mitigating the effects of a state-induced stimulus. This is the reason for the tepid impact of the current stimulus packages [Balakrishnan, 2009].

The first option, credit expansion by bubble-blowing by corporations and banks, is also unavailable as these avenues are closed-off. The real-estate bubble has burst, the housing market is languishing, credit cards are over-extended. Dubai's real-estate now sports more cranes than building occupancies, student loans are a slow-burning crisis, the Shanghai real-estate bubble has been pricked by Chinese authorities. In the U.S. and the U.K., mortgage delinquencies threaten to escalate as citizens without jobs face come-due, first-time balloon payments.

One prognosis as to the future of capitalism may be found in the writings of Adam Smith and his contemporaries that, in the long term, capitalism will gravitate to a steady-state [Balakrishnan, 2009]. What this thesis fails to grasp is the dynamic character of capitalism, its ability in the past to "invent" its way out of crisis by destroying and then replenishing the capital stock of entire countries like Germany and Japan with Marshal Plan and today Iraq. However, today seems to be different with stubbornly high levels of unemployment and the ominous possibility of social unrest in the U.S. already evident on a global scale, led perhaps somewhat ironically by Greece, the cradle of western civilization [Marx, 1977; Braverman, 1998].

The Concentration of Capital: The concentration of capital refers to the growing size of banks and corporations.[11] The savings and

[11] Marx [1977, Vol. 1, p. 887] elaborates on these contradictions as they applied in the 1850's (and as they relate now): "...The concentration of capital within a country and the dissolving effect of this concentration present nothing but positive sides to him [Carey]. But the monopoly of concentrated English capital has a dissolving effect on the smaller national capitals of other countries and is disharmonious….these world-market disharmonies are merely the ultimate ad-

loans crisis of the 1970's was "deferred" by absorbing bad banks into good and larger ones. The same tactic was redeployed for engaging the current crisis. To avoid bank collapses and a systemic meltdown, presaged by Lehman Brothers, banks were permitted to engage in an unprecedented program of mergers and acquisitions. Bear Sterns was absorbed by J.P. Morgan for $29 million; Bank of America "saved" Merrill Lynch for $130 million; Northern Rock, the Abbey, and Bradford and Bingley were absorbed in the U.K.; Wakovia went to Wells Fargo; WAMU to Bank of America; Morgan Stanley to Mitsubishi; and Fortis and Dextor were swallowed in French, Dutch, and Belgian bailouts.

Consolidating banks does not "solve" problems; it merely transformed them into new and larger contradictions, setting the scene for future crises. These new mega-banks are now even bigger, too big to save by their host countries, and their size magnifies ever further the degree of systematic risk. A mega-bank collapse will have unprecedented reverberations through the world financial system because bank interconnectedness is now pervasive.

Figure 1 is a "too big-to-save" table. It assigns the world's largest 25 banks to their host country and expresses their combined leverage of that country's GDP. Ireland and Greece do not appear, not because their situation is not dire, but because their banks and GDP are not large enough in absolute terms to qualify for consideration. This is a limitation of Figure 1, a drawback with these data because, as we have seen in recent months, the euro can be jeopardized by a minnow like Greece and via the IMF, there is a contagion effect that threatens to embroil the U.S.

The voracious, expansive proclivities of capitalism are represented by the expansion of the commodity form (Marx, 1977, pp. 700-883). Congress because of lobbying is now commoditized such that banking regulation is subordinated to the dictates of market forces, personified by "the lobbyist" [Stigler, 1971; Sy and Tinker, 2009]. Even the Volker rule (the firewall for segregating high-risk investment banking from federally insured deposits in commercial banks) has fallen afoul of the powerful banking lobby [Stigler, 1971; Sy and Tinker, 2009]. Thus, if a

equate expression of the disharmonies which have become fixed as abstract relations with the economic categories or which have a local existence on the smallest scale. No wonder, then, that he [Carey] forgets the positive content of these processes of dissolution..."

FIGURE 1

Too-Big-To-Fail Index: Top 50 Banks' Leverage as a % of Their Country's GDP

COUNTRY	TOP 50 BANKS' LEVERAGE AS A PERCENTAGEOF THEIR HOST COUNTRY'S GDP
Switzerland	595.32
Netherlands	336.86
Belgium	318.84
United Kingdom	206.21
France	198.07
Hong Kong	154.74
Spain	107.77
Japan	102.16
Sweden	82.96
Australia	82.07
Italy	70.32
China	63.26
Germany	49.88
United States	44.19
Canada	28.80

Source: Eurobank	http://www.euromoney.com/Article/1961042/Worlds-largest-banks-2007-Global-bank-rankings-Top-20-global-free-to-access.html
Source: Euromoney	http://www.euromoney.com/Article/1533691/Worlds-largest-banks-Global-bank-rankings-Top-50-by-shareholder-equity-free-to-access.html

future Goldman Sachs suffered catastrophic losses in, say, the Hungarian, Russian, or Romanian stock markets, wiping billions of assets off its balance sheet, it would be U.S. taxpayers who would be obliged to pick up the tab to protect U.S. federally insured depositors.

The travails of the euro began with Greece, but grumblings in Ireland, Spain, and Portugal have spooked international financial markets, including the U.S. The IMF (with its U.S. paymaster) saved Greek banks which owed $50 billion and $80 billion to French and German banks respectively. So the U.S. is indirectly, but very significantly ensnared, in euro travails. And in Germany, the bailout is costing Chancellor Angela Merkel's party dearly in the polls. The German voters do not like the Greeks!

Back in the U.S, the stock market dimly perceived that the fate of the euro is not just a "foreign" problem. The geographical growth of the commodity form in banking means that when the euro sneezes, the U.S. will catch cold.

The Growing Centralization of Capital: Centralization of capital, in popular parlance, refers to the manner in which control of capital is in the hands of fewer and fewer persons. In this regard, centralization and concentration move in lock step.[12] However, Marx's definition of "concentration" is a variance from this popular notion. For Marx [1977, Vol. 1, Chapter XXXIII], "… Centralization of the means of production and socialization of labor at last reach a point where they become incompatible with their capitalist integument. Thus integument is burst asunder. The knell of capitalist private property sounds. The expropriators are expropriated."

For Marx, in his time, his notion of centralization focused on the revolutionary potential of increasingly socialized, increasingly socially conscious, factory labor. In his era, the socially disruptive potential of factory labor was amplified through trade-union organization and even political representation (e.g., the Labour Party and the Fabian Society in the U.K.).

Today's trade unions in the U.K. and the U.S. are a shadowy version of their earlier potency. It is easy to rush to the conclusion that Marx's tocsin is no longer relevant today given the

[12] This popular definition serves the convenient ideological purpose of personifying the source of crises in terms of "villains and bad people," to paraphrase President Bush. This ploy diverts attention away from the real source of crises, not "bad people" (the market can simply replace them with more highly qualified bad people) but contradictions in the underlying social system.

emasculated condition of trade unions. However, this misapprehends Marx's analysis that does not depend on the presence and form of the trade-union movement. The basic social antinomy to which Marx refers is not socially and institutionally specific but is capable of assuming different institutional guises at different points in history.

The basic dissonance persists today, but today assumes new forms. The social self-consciousness that evolves from Marx's "centralization of the means of production and socialization of labor" is reflected in the awareness displayed by rioters in Spain, Portugal, and Greece ("IMF, go home"). The insurrectionists at Toronto's G8 meeting ("kill the bankers") and the agitators behind the growing number of strikes for better wages and benefits in China echo similar sentiments.

The Misalignment between Identity and Non-Identity: The "clash" between identity and non-identity is perhaps the most pertinent and theoretically challenging addition offered in this update. Best elucidated by Adorno [1973] and Adorno and Horkhiemer [1979], this "clash" describes the rupture between a social self-consciousness (whether of an individual or a collective) and the historical milieu in which that self-consciousness is embedded.[13] The rupture or clash refers to the manner in which consciousness or self-awareness always lags behind its evolving historical milieu.

Hegel [1967, p. 13, 1975, pp. xiii, 4, 70; see also Lukacs, 1971, p. 59] expresses this relation succinctly: "Only when dusk starts to fall does the Owl of Minerva spread its wings and fly." In the same vein, Marx notes that "…the conventional philosopher always arrives after the feast has ended." ("post-festum").[14]

In contrast with this backward-looking recollection "at dusk" (the "post-festum" analysis of the traditional intellectual), Gramsci's [1971, pp. 404-405] organic intellectual is an active ingredient in social change (a dialectical dynamic of interven-

[13] "An object can be conceived only by a subject but always remains something other than the subject whereas a subject by its very nature is from the outset an object as well. Not even as an idea can we conceive a subject that is not an object, but we can conceive an object that is not a subject. To be an object also is part of the meaning of objectivity to be a subject" [Adorno, 1973, p. 183].

[14] "Hegel's…absolute spirit qua absolute spirit makes history only in appearance….For, as absolute spirit does not appear in the mind of the philosopher in the shape of the creative world-spirit until after the event, it follows that it makes history only in the consciousness, the opinions and the ideas of the philosophers, only in the speculative imagination" [Marx, quoted in Lukacs, 1971, p. 16].

tion and change; not a static, bifurcated Cartesian subject-object split, but a philosophy where object and subject constantly reconstitute each other, albeit imperfectly):

> …the philosophy of praxis is a reform and a development of Hegelianism; it is a philosophy that has been liberated (or is attempting to liberate itself) from any unilateral and fanatical ideological elements; it is consciousness full of contradictions, in which the philosopher himself, understood both individually and as an entire social group, not only grasps the contradictions, but posits himself as an element of the contradiction and elevates this element to a principle of knowledge and therefore action.[15]

The essence of the proposition that "reality" always exceeds consciousness means that reality is always capable of delivering nasty surprises. In the language of dialectics, the "negation-of-negation" is never a complete apprehension of reality but always something less, a synthesis with remainder. This remainder is the unexplained residual (surprise) that provides the accelerant for the next historical movement.

Today's world-wide crisis provides a practical example of dialectics in action. The crisis was precipitated in no small measure by a banking crisis. This "negation" has been "negated" by a faint-hearted regulatory reform, an imperfect expression of Adorno's public consciousness. The negation-of-negation never provides a definitive, final, or absolute closure, but always leaves a remainder or a residual out of which future crises will emerge.

These insights from Marxist dialectics, as formulated by Theodore Adorno and cited extensively in our 1987 text [Neimark and Tinker, 1987], articulates in a systematic matter what is suspected in popular understandings of the banking crisis. Banks successfully resisted the Basle lll efforts to impose higher equity cushions. They defeated restrictions on leverage levels and a collective levy to fund the cost of future bailouts. U.S. banking legislation is also floundering in Congress, with the Volker rule seemingly dead in the water already. The banking lobby successfully resisted these regulations by arguing that, in their present parlous state, any restrictions might fatally destabilize the entire banking system, precipitating a new and even

[15] In such a fashion, Hegel/Gramsci's Organic Owl appears on time for Marx's banquet and enjoins the guests with a "steak" in the future (becoming an historical player in making history).

greater crisis.[16]

The result of these insipid, negation-of-negation reforms is to set the scene for the next financial crisis. Since the previous crisis, systemic risk has increased. Banking entities are now really too big to save, and the firewalls between high-risk investment banking and commercial (high street) banking have been dismantled. These were provisional "solutions" that sewed the seeds for the next crisis.

Yet, banks may not be the epicenter of the next crisis. Nation states, including the euro-zone, are increasingly vulnerable to defaults, not just for their sovereign government debt, but also for default of their private banking sectors, as in the case of the loan exposure of German banks to Greek banks. Already bailout fatigue is setting-in in Germany, and new euro-zone zombies (Spain, Portugal, Ireland) may be thrown to the wolves by German voters.

The outcome for these "the three amigos" may not be pretty. Their government and bank bonds will be downgraded to junk status with increasing interest rates to prohibitive levels. This will impose additional severe burden on their government deficits with likely violations of the debt covenants of IMF and euro loans triggering further penalties. And so the dialectical roundabout begins again, this time with greater speed.

Citizens are not likely to sit quietly by and accept draconian cutbacks in jobs, social services, and benefits. People who lose the ability to pay the rent, buy food for their children, and maintain healthcare payments, etc. are unlikely to remain quiescent in a crisis not of their making. At the time of writing, the renewal of unemployment benefits has stalled in the U.S. Congress, with Republicans demanding that the benefits be funded from cuts elsewhere. Street protests in Canada against the G20 and those in Greece were not amicable. It would be foolish to continue to deny that social instability is not a real possibility.

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[16] This tactic is akin to threatening to commit suicide to avoid taking one's flu shots.

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