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ACCOUNTING HISTORIANS JOURNAL

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Authors may find the following guidelines helpful.

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

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

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

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

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NOTE FROM THE CO-EDITORS

2008 Manuscript Awards

We are pleased to announce the following winners of the annual AHJ Manuscript Competition for Volume 35 (2008) which awards $500 for the article judged best by the editorial board and $250 for each of two others for excellence.


RUNNERS-UP: Masayoshi Noguchi and John Richard (Dick) Edwards, “Professional Leadership and Oligarchy: The Case of the ICAEW”

Lynne Oats and Pauline Sadler, “Accounting for the Stamp Act Crisis”

Congratulations to the authors for these fine pieces of work.

It should be noted that every article in Volume 35 received at least one vote on the ballots submitted.
“EFFECTIVE” GENEALOGICAL HISTORY: POSSIBILITIES FOR CRITICAL ACCOUNTING HISTORY RESEARCH

Abstract: This essay, following up on the recent Sy and Tinker [2005] and Tyson and Oldroyd [2007] debate, argues that accounting history research needs to present critiques of the present state of accounting’s authoritative concepts and principles, theory, and present-day practices. It proposes that accounting history research could benefit by adopting a genealogical, “effective” history approach. It outlines four fundamental strengths of traditional history – investigate only the real with facts; the past is a permanent dimension of the present; history has much to say about the present; and the past, present, and future constitute a seamless continuum. It identifies Nietzsche’s major concerns with traditional history, contrasts it with his genealogical approach, and reviews Foucault’s [1977] follow up to Nietzsche’s approach. Two examples of genealogical historiography are presented – Williams’ [1994] exposition of the major shift in British discourse regarding slavery and Macintosh et al.’s [2000] genealogy of the accounting sign of income from feudal times to the present. The paper critiques some of the early Foucauldian-based accounting research, as well as some more recent studies from this perspective. It concludes that adopting a genealogical historical approach would enable accounting history research to become effective history by presenting critiques of accounting’s present state.

INTRODUCTION

This essay contrasts two stereotypical genres of historical narratives – traditional and genealogical. Historians of the traditional kind are concerned to uncover the truth about the past. This assumes that they have the confidence in their capacity to find it and to recognize it when they see it. Genealogical

Acknowledgments: The author is indebted to the Social Science and Humanities Research Council (Canada) for partial support for this research and to participants in the Accounting, Business, and Financial History Workshop, Carmona, Spain, 2006 for their helpful comments and suggestions.
historians, in contrast, reverse this stance. They do not want to know the truth about the past, but rather about the fictions of the present. They want to show how the “truth” is made, not discovered. In doing so, however, they do not want to show how the present is better than the past, thus revealing how western civilization has progressed with time. Instead, for genealogists, the present seems just as strange as the past. So instead of making the present familiar and seeming natural and inevitable, they look for and document this strangeness. They produce a genealogical history that de-naturalizes and exposes its strangeness.

This essay can be seen as a follow up to the recent Tyson and Oldroyd (T&O) debate with Sy and Tinker (S&T). S&T [2005, p. 49] contend that because of “accounting history’s resolute adherence to empiricist, archival and otherwise antiquarian epistemes ... [it] has forfeited its opportunities to speak authoritatively from the past about problems that beset accounting in practice.” They see this as “a missed opportunity of tragic proportions for accounting historical research because it has undermined its authority to address problems in accounting practice and theory today” (p. 52). Thus, S&T argue, much accounting history research has failed to present critiques of the present state of accounting’s authoritative concepts, principles, theory, and present-day practices by retreating to the ideology of archivalist empiricism. Archivalists’ claims to independence and objectivity, they maintain, are unsupportable and fallacious; the truth is made not found, and facts are notoriously frail.¹ Invoking post-Khunian theory, they see accounting historians as presenting conservative renditions which mask a latent, normative, political agenda. In contrast, “relevant history is history that speaks in a meaningful way to the quandaries of the present” (p. 63). They gesture towards Marx and Engel’s theory of historical/dialectic materialism for ontological and epistemological guidance and call on the accounting historian to “align herself with that judged to be morally and socially appropriate” (p. 49).

T&O [2007] respond to S&T’s charge that accounting historians do not critique the present state of accounting due to their strict adherence to archivalist, objectivist epistemology. They challenge S&T’s contention that Khunian and post-Khunian paradigms have put paid to archivalism with its belief in objectivity and factualism. T&O see Kuhn’s epistemological

¹As Nietzsche [1968, p. 301, item 556] observes, “There are no ‘facts-in-themselves, for a sense must always be projected into them before there can be ‘facts.’”
outlook as neutral regarding truth rather than being relativistic as S&T contend. Moreover, “Most accounting historians accept the subjectivity of historical truth, but this does not mean that truth does not exist or that it is not worth looking for ... events do happen ... and for a reason, even if it is an accident” (p. 181). But most importantly, for purposes of this essay, they conclude that, “We do not believe accounting historians have the authority or are well situated ‘to address the problems in practice and theory today.’ That undertaking is better left to social activists, contemporary critics, and accounting regulators....Rather, historians should continue to examine, illuminate, and interpret the past” (p. 188).

T&O’s stance seems particularly strange given that as academic researchers, they surely have the authority and as tenured accounting professors have the knowledge and intellect to address the problems of today’s accounting practice and theory. After all, one of the primary roles of universities through their academic faculty is to challenge the quandaries and ills of the status quo as they see them. This essay, then, takes umbrage at their apolitical stance. Richardson [2008, p. 257] recently put it well, arguing that accounting historians should aim to be controversial and be attentive to current institutional issues such as standard setting, accounting education, and the politics of the accounting profession.

THE SITUATION TODAY

The situation today in the financial accounting world is a case in point. The promulgated IFASs, the joint effort of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB), as well as U.S. GAAP, appear strange when examined closely. This body of accounting rules and concepts seems much more a labyrinth of one-off, separate, often incommensurable, and frequently contradictory axiomatic statements, which are espoused as universal rules and principles for accounting problems and practices more than they are a coherent body of knowledge resting on solid foundational, conceptual frameworks. As former FASB chairman Herz [2005, p. 4] observed: “The fact is that what we call U.S. GAAP is comprised of over 2,000 individual pronouncements by various bodies and organizations in a variety of forms.” He describes this vast corpus of accounting principles, rules, concepts, regulations, interpretations, implementation guides, etc. as disjointed, frequently in conflict, extraordinarily detailed, and complicated,
so much so, “that only a rapidly decreasing number of CFO’s and professional accountants can fully comprehend all the rules and how to apply them.” He also notes that a diverse array of public and private bodies, institutions, and committees contribute to this vast body of official pronouncements.2 “The result,” Herz believes, “is a body of official accounting literature that is hard to understand and difficult to use. In one word, nuts!” (p. 5)3 Surely, this is a strange situation indeed for one of the most important discourses of present-day global capitalism. The current joint IASB/FASB concepts and GAAP are fast mirroring this state of affairs.

Furthermore, a large corpus of accounting studies has uncovered mounds of evidence that earnings management/manipulation practices are widespread globally. Several researchers have documented games that corporate financial officers play with investment analysts and capital market players [see, for instance, Richardson et al., 2004; Bartov and Moharan, 2004]. Research has also identified the major means by which earnings/manipulation is accomplished, including: structured transactions [O’Brien, 2005] and negotiations regarding contentious reporting issues between corporate financial officers and the enterprise’s auditors [Gibbins et al., 2001]. Ironically, sophisticated investors like to see some earnings manipulation since it is a sign of competent CFOs [Bartov et al., 2002].

Traditional historians tend to be silent on the current state of the accounting world, and some might even see the ongoing convergence concepts and GAAP projects as progress, whereas those subscribing to the genealogical approach would perceive them as strange and certainly not progress. A case in point is the fact that not so long ago in, say, the mercantile age, merchants bought and sold real, material goods (woolen garments, spices, wines, foodstuffs, etc.) to which accounting reports unambiguously referred. But today, the traders of stocks and derivatives,

2These include the FASB and its predecessors, the Accounting Principles Board and the Committee on Accounting Procedures, the Emerging Issues Task Force (EITF), and the Accounting Standards Executive Committee of the American Institute of Certified Public Accountants. The Securities and Exchange Commission (SEC) alone has a vast number of core rules, including Regulations S-X and S-K, more than one hundred specific Staff Accounting Bulletins, nearly fifty Financial Reporting Releases, and hundreds of Accounting Series Releases.

3Herz [2005, pp. 4-5] points out that “the SEC also proclaims its latest views on particular reporting and disclosure matters through speeches and comments at EITF and other professional meetings, which, while not official, effectively carry the same weight for anyone trying to comply with all the rules.”
hedges, swaps, etc., seated in front of a bank of computers and telephones, trade trillions upon trillions of Euros, dollars, yen, etc. in a vast global, capital-market economy of hyper-real, non-material signs, dealing with people they have never met or seen, a phenomenon that many experts see as a major cause of the current stock market collapse. Surely, this would appear to be a very peculiar, even unnatural, turn of events to the medieval merchant who bought and sold real material things and who dealt with real people. What is even stranger is that GAAP requires accountants to put a valuation on these non-material signs and report them on financial statements (i.e., mark-to-market accounting). A genealogical history would bring such strangeness into the light. Accounting for deferred income taxes, pension liability and expense, and stock options when looked at closely also seem strange, and, therefore seem to be good potential targets for genealogical research. The inspiration for genealogical history comes from the influential work of Friedrich Nietzsche (1844-1900).

**TRADITIONAL HISTORY**

Traditional history can lay claim to four fundamental strengths. First, it investigates only the real, where evidence of the real is verifiable, historical facts. As the eminent historian Hobsbawm [1995, p. viii] stated: “The point from which historians must start, however far from it they may end, is the fundamental and, for them, absolutely central distinction between established fact and fiction, between historical statements based on evidence, and subject to those which are not.” The Spanish Inquisition, the French Revolution, World War I, the American and British leveling of Iraq in 2003, the Holocaust, the Gulag, and the genocidal attacks on the Basque separatists did happen in real places, to real people, by real people. “Without the distinction between what is and what is not so, there can be no history ... [and] the ability to distinguish between the two [fact and fiction] is absolutely fundamental” (pp. viii, 6).

Traditional history also identifies the past as a permanent dimension of the human community and consciousness. We carry it around with us as a “sense of the past.” Its patterns tend to

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4 Many observers have seen mark-to-market accounting as a major contributor to the lending crisis and stock market crash of 2008-2009.

5 See Carmona et al. [2004] for a detailed comparison of traditional accounting history with the new accounting history.
get reproduced in what we consider to be important about our lives. Many walks of life – judiciaries, politicians, bureaucrats, members of professions like accounting and law, the military – frequently search for historical precedent when making judgments and decisions. Many people today have more in common with their forbearers than with their contemporaries. History not only illuminates the past, it also throws light on the present. “To be a member of any human community is to situate oneself with regard to one’s past ... the problem for historians is to analyze the nature of this ‘sense of the past’ in society and to trace its changes and transformations” (p. 10). Even when ideologues distort or reinvent the past, they retain the sense that the past is important. The pull of the past as tradition and continuity is strong.

The third strength is that traditional history has much to say about contemporary times. It is a storehouse and repository of the experiences, the wisdom, and the follies of the past, and so it should provide the material for making a better world today. While much of the human situation and temperament stay about the same from epoch to epoch, much improves when lessons from the past are recalled and acted upon. Even when people in high places ignore or distort the lessons of history, historians must keep trying and act as myth slayers (p. 274). History has much to say about the present.

The final strength is that it sees the past, present, and future as constituting a continuum. The present is systematically tied to the past, and the future is a seamless web of progress even though today’s social structures and the patterns of reproducing them put a limit on the number and kind of things that can happen tomorrow. But historians can, if they try, predict social trends and perhaps influence in important ways what will happen in the future. As experts on the past, they should be able to provide insights into what possibly might happen. And if these possibilities are deemed to be undesirable, it behooves historians to speak out.

In sum, traditional history is concerned with the investigation of real events and real people. It holds that the past strongly influences the shape of the present, and that we can learn a great deal from the experiences, wisdom, and mistakes of the past, but only if we pay attention to it. It sees the past, present, and future as constituting a seamless web in time. Thus, historians can and should predict important trends which might be acted upon to help shape a better future. These presuppositions are underpinned by the epistemological belief in “the supremacy of
Macintosh, *Nietzsche’s Genealogical History*

Traditional historians, then, are wont to make a sharp distinction between strictly scientific procedures and rhetorical constructions, between fact and fiction. Facts are deemed to be statements supported by evidence from *primary* sources. *Secondary* sources are also important in that they provide support for primary sources. Nietzsche, however, had serious reservations about the benefits of traditional history for society and for the individual.

**NIETZSCHE’S GENEALOGY**

Nietzsche was wary of the efficacy of traditional history on several counts. He worried, for example, that too much focus on the great deeds of men of the past would hinder the enhancement of society and the individual, particularly the latter’s potential for “overcoming” the present state of affairs and the development of his or her own morals. Such reverence would serve only to preserve a way of life, not enhance it. He was also concerned that excessive reverence for the past leads to a forgetfulness of the dark side of mankind’s historical past and hampers attempts by men of action to try something new for fear of offending some sacred belief [Nietzsche, 1968]. He saw history as more than an accurate account of some element in the past. Rather, we need history “for the sake of life and action … We want to serve history only to the extent that history serves life” [Nietzsche, 1983, p. 59]. These reservations led Nietzsche to formulate a critical, “effective” history, what he called *genealogy*.

In *The Genealogy of Morals*, Nietzsche [1956] addressed four questions that had haunted him about the provenance of moral prejudices. “Under what conditions did man construct the value judgments good and evil? And what is their intrinsic worth? Have they thus far benefited or retarded mankind? Do they betoken misery, curtailment, degeneracy or, on the contrary, power, fullness of being, energy, courage in the face of life, and confidence in the future?” (p. 156) Underlying these questions was a more fundamental puzzle, one that he pursued for most of his life. What was the end or purpose of valuing, what was the value of values? Nietzsche thought of values as those important traditional notions of a particular civilization that are deemed to deserve reverence and esteem. Western civilization, for example, he observed, has valued good over evil, altruism rather than egoism, truth over falsehood, and individualism over the herd. The leading French and English moral philosophers at the time were declaring that utilitarianism and altruism were the basic and
intrinsic psychological material of human nature and that the “good” is what is of personal use along with a selfless concern for others. Nietzsche, however, saw such efforts as “a perverse and upside-down variety of genealogical hypothesis” (p. 152).

The “English psychologists,” as he called them, made two fundamental errors. In the first instance, these “microscopic examiners of the soul...glorified and transcendentalized the non-egotistical instincts of compassion, self-denial, pity, and self-sacrifice” (p. 153), treating them as absolute values thus showing, “a will that had turned against life” (p.159). They “think unhistorically, as is the age-old custom of philosophers” (p.159). In contrast, Nietzsche believed that the key to understanding morals involved conducting historical research into the provenance of specific values and documenting the major changes in their meaning during their descent to the present. Nietzsche’s aim was to produce what he called “effective history” by exposing how the currently reigning morals of a society are just as suspect and unnatural as those that held sway in past eras. A genealogical analysis, he believed, would unsettle, de-nature, and de-doxify the taken-for-granted meanings of currently prevailing values, thus opening spaces for new ways of moralizing.6 He hoped this would show the way to overcome the hegemonic effects of the currently reigning values, thus enabling the individual to create his or her own moral standards.

By tracking the origins of the terms good and bad back in time, for example, he hoped to pinpoint their origins and record the radical ruptures and reformulations in the meanings attributed to them over the years. With this aim in mind, Nietzsche embarked on his genealogical project. He found evidence that in ancient Greek society, these terms merely differentiated two major classes – the patrician and plebeian classes. Good was simply the aristocracy’s way of life that distanced them from the lower, dependent class. “Good,” however, was not good in the sense of being superior to “bad.” It was simply a term to distinguish the noble from the rest of society. Nor did “bad” signify bad in any disrespectful, disdainful, or disreputable sense. The good (the noble) needed the bad (the rest) and the bad needed the good.

The term “good,” however, did indicate the power and

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6 Rorty [1989] followed Nietzsche in this line of thought to develop his philosophy of striving for “new final vocabularies” while recognizing that, ironically, a liberal pragmatist would recognize that it would not be “final” but rather one stage of an endless series of new final vocabularies. He believed that to change our talk is to change what we are.
wealth of the aristocrats and even more so a character trait and a temperament thought to be typical of that class. Good referred to the characteristic spirit of a person who has a true reality and who has nobility. Moreover, good as a trait was not for Nietzsche some thing-in-itself, existing out there beyond language that could be discovered by philosophers or scientists. Rather, it was a term that came into being as a result of the handiwork of the high-minded nobility, who simply decreed their own actions, and thus themselves, to be the good. “The basic concept [the good] is always noble in the hierarchical, class sense, and from this developed ... the concept good embracing nobility of mind, spiritual distinction” (p. 162). In parallel with this, the term bad merely indicated “the notions common, plebian, base” (p. 162).

Importantly, however, for the ruling class, “The lordly right of bestowing names is such that one would almost be justified in seeing the origin of language itself as an expression of the rulers’ power. They say, ‘this or that’; they seal off each thing and action with a sound and thereby take symbolic possession of it” (p. 162). The ruling ideas are the ideas of the rulers, not of some permanent, transcendental, metaphysical doctrine.

In further support of the claim that good and bad originally were merely descriptive as opposed to value-laden, Nietzsche pointed to the German words schlect (bad) and schlict (simple). For a long time, the first term was used interchangeably with the second “without any contemptuous connotation as yet, merely to designate the commoner as opposed to the nobleman” (p. 162). Much later, in the early part of the 19th century, the meaning of these terms had somehow changed to take on their present-day connotations. Good and bad became hierarchical, with good superior to bad.

This value-laden hierarchy, Nietzsche observed, came into being as the handiwork of those holding the upper hand in the social order. For example, in previous European eras, the conquerors’ own physical characteristics were peremptorily designated as good and those of the vanquished as bad. In pre-Aryan Italy, as a case in point, the original settlers were much darker in skin and hair than were their blond, Aryan conquerors (p. 164). Similarly, the Gaelic name Fingal (from the French term fin that signified “fine”) was a term for the fair-haired invaders of Ireland as opposed to the dark, black-haired, indigenous population (p. 164). The former saw themselves as noble and good and deemed the indigenous people as malus. In such cases, the conquerors identified good with their own physical characteristics and bad with those of the suppressed. What was decreed to be good or
bad later came to be “naturalized” in virtue of the current rulers’ power positions. Nietzsche [1968] did not attribute this to any utilitarian or altruistic psychological traits, but rather to their will-to-power.

These meanings took another radical rupture in ancient Israel when a “priestly system of valuations branched off from the aristocratic and developed into its opposite” (Nietzsche, 1956, p. 166). This priestly aristocracy had come into prominence in opposition to the warrior caste who placed a high value on traits such as strong physique, exuberant health, and chivalry, and who savored “combat, adventure, the chase, dance, war games, etc.” (p. 167). In contrast, the priests decreed that the underprivileged, the poor, the powerless, the sick, the ugly, and the impotent were the truly blessed and worthy of God’s grace. The noble and mighty were now deemed to be avaricious, vain, cruel, and, consequently, evil and damned. Only the wretched of the earth were worthy of living in paradise with God. With this cunning rhetorical move, the priests had turned the tables on the warrior caste. What previously had been taken to be good became evil; what was previously taken to be bad was now good.

Nietzsche saw the Israeli priestly caste as the perpetrators of this radical reversal. They had set the stage for the gospel of “love made flesh” with the coming of the redeemer Jesus of Nazareth “who brought blessing and victory to the poor, the sick, the sinners of the earth ... what could equal in debilitating narcotic power the symbol of the ‘holy cross,’ the ghostly paradox of a crucified god, the unspeakable, cruel mystery of God’s self-crucifixion for the benefit of mankind? One thing is certain, that in this sign Israel has by now triumphed over all other, nobler values” (p. 169). Weakness was now merit and strength pernicious.

In the face of this and other such critical reversals in the reigning values of a culture or of a civilization, Nietzsche came to some momentous, if startling, conclusions, ones which contradicted traditional philosophical thinking. He argued that there is no value without an evaluation. But since valuation is an act of will that proceeds from a particular perspective, it follows that, “Through esteeming alone is there value” [Nietzsche, 1973, pp. 1, 15]. Thus, Nietzsche’s great insight, “Whatever has value in our world now does not have value itself, according to its nature – nature is always value-less, but has been given value at some time as a present – and it was we who gave and bestowed it” [Nietzsche, 1974, p. 301].

Nietzsche, then, saw values as the result of humans willing
them into existence. They are created by humans who, in virtue of their “will-to-power,” wish to preserve, maintain, and hold sway over a particular way of life. Importantly for genealogical researchers, values are linguistic objects that exist in their own right and can be studied as such. Such research can discover the origins of specific values, document the specific conditions under which they made their appearance, and trace their radical ruptures and reformulations during their descent to the present day. It can serve to de-naturalize and de-doxify the currently taken-for-granted dominant status of reigning values of the status quo. Thus, spaces can be opened up for alternative ways of seeing the present, for making it seem as strange as previous eras look to us today. Foucault [1977] endorsed and extended Nietzsche’s effective history perspective.

FOUCAULT’S NIETZSCHEAN GENEALOGY

In his essay Nietzsche, Genealogy, History, Foucault [1977] investigates in some depth and endorses Nietzsche’s notion of genealogy, especially his various uses of Ursprung as the original basis of morality and his idea of effective history. He agrees with Nietzsche’s conclusion that there is no lofty, original primordial, pristine, timeless, and essentialist essences at the moment that the idea of morality first appeared, as well as ideals such as justice, truth, and reason that are vital for a culture. Rather, if we as genealogists “listen” to history, we find that “they have no essence or that their essence was fabricated in a piecemeal fashion” (p. 142). For example, instead of “divine birth” when humans “emerged dazzling from the hands of a creator,” we find that, “historical beginnings are lowly” (p. 143). Zarathustra’s monkey, “who jumps along behind him, pulling at his coattails” (p. 143), reminds us that we are descended from the apes. The historical development of humanity is merely a series of interpretations and discontinuities. Thus, Foucault came to believe, “History becomes ‘effective’ to the degree that it introduces discontinuity into our very being ... and it will not permit itself to be transported by a voiceless obstinacy toward a millennial

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7 The current state of accounting includes a host of topics amenable to genealogical historical research, including, for example, the widespread earnings manipulation phenomenon; accounting for deferred taxes and deferred pension expense; and accounting for certain derivative option securities using other comprehensive income accounts.

8 I am indebted to an anonymous reviewer for suggesting the inclusion of Foucault’s genealogical, effective history.
ending. It will uproot its traditional foundations and relentlessly disrupt its pretended continuity” (p. 154). The history of human-kind has neither pristine, original essence nor any final, eternal, destiny resting place guided by metaphysical fixed laws.

Such a position led Foucault (p. 146) to refuse the search for origins. Instead, he saw that the genealogist’s task:

... is to maintain passing events in their proper dispersion; it is to identify the accidents, the minute deviations – or conversely, the complete reversals – the errors, the false appraisals, and the faulty calculations that gave birth to those things that continue to exist and have value for us; it is to discover that truth or being do not lie at the root of what we know and what we are, but the exteriority of accidents.

Mahon [1992, p. 112] neatly sums it up, “The genealogist sees the present state of affairs and present needs as another episode; not the result of a meaningful development, but the result of struggle and the relations of force and domination.” As Foucault said in an interview with Simon [1971, p. 192], “It is a question basically of presenting a critique of our own time, based on retrospective analysis, a critique of those systems within which we are trapped.” Effective history, for Foucault, as with Nietzsche, has value as both a diagnostic and a curative critique of the present.9

GENEALOGISTS’ CRITIQUE OF TRADITIONAL HISTORY

Genealogists are wary of traditional historians on several fronts. They see them as structuralists who attempt to excavate the large-scale patterns (the gestalt) of some kind of great and enduring forces at work that persist across time and circumstance operating below the surface of the life world.10 That is to

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9Foucault’s Nietzsche, Genealogy, History [1977] essay signaled his epistemological turn from archeology to genealogy. See especially pp. 154-157 for his ontological and epistemological presuppositions regarding genealogical, effective history and how to conduct it.

10Structuralists of all kinds hold that structures, the organizing properties or blueprints of any system, are ubiquitous in both nature and culture. Moreover, they believe that everything that is not indivisible in its very nature exists as a complex whole, amenable to analysis of its constituent parts. Each part has no meaning on its own but only by virtue of its relationship to all the other parts and to the master plan of the system. So the surface behavior of the system, including its enduring and discernable patterns, is controlled by the below-the-surface structures, its pre-established harmony. See Sturrock, 1986, for an excellent comparison of structuralism with post-structuralism.
say, they try to discern the deep underlying continuities, those forces which determine how we have progressed and which explain the present. Genealogists eschew such endeavors as contrived fictions. Thus, genealogists oppose “the Augustinian view of history as recording a divinely scripted linear and teleological sequence of events ... and unfolding story with a beginning (the Creation), a middle (the Incarnation) and an eventual end (the Last Judgment). So the traditionalist integrates what otherwise might seem like unconnected events as being moved by the hand of God” [Prado, 2000, p. 33]. In general, the traditionalist looks to excavate below-the-surface principles that determine and explain the present and its teleological progression. Genealogists, however, abjure such a position, calling it “doing metaphysics.” They repudiate ideas, for example, that behind the unfolding of historical events is some kind of guiding hand (e.g., God, the laws of the market, or reason) that animates humans and determines the flow of history. Instead, they focus on what can be seen on the surface.

Genealogists also see traditionalists as seeking to restore an unbroken continuity to history that purports to harmonize past events and personages into some kind of a meta-narrative featuring a discursive, seamless web stretching into the future by revealing how some hidden forces (such as progress and rationality) putatively illuminate the present. Yet, they can only achieve this, genealogists argue, by imposing some kind of a predetermined form on the vicissitudes, disparities, and haphazard happenings of the past and assimilating them into a coherent, discursive formation that takes into account and treats as significant only those events and personages that fit snugly into its meta-narrative. Thus, the past gets frozen into a sequence of integrated and determinant events. As Foucault [1971, p. 154] contends, “The forces operating in history are not controlled by destiny or regulative mechanisms, but respond to haphazard conflicts.”

Genealogists object to any such consecration. They see such efforts only as a handy way to compile disparate factors with no apparent interrelatedness into a logical net that can only be accomplished by the retrospective imposition of some grand historical interpretation. Instead, the genealogist wants to conduct historical research as critique by exposing the unrecognized operation of power in the everyday lives of individuals. As Mahon [1992, p. 14] neatly puts it, “Nietzsche’s genealogy is a unique form of critique which recognizes that the things, values, and events of our present experience have been constituted his-
torically, discursively, and practically. Genealogy is an attempt to lay bare that constitution and its consequences; it reveals the historical, discursive, and practical conditions of existence of such things, values, and events.”

A genealogy of the moral value “virtue,” for example, might begin with the modernistic liberal view that equates virtue with rational altruism (a major good) and which is deemed to be the opposite of naturalistic egoism (a major vice). Going back in time, for early New Testament Christians, faith, hope, charity, love, humility, and poverty were characteristics of the virtuous person. For the Greeks like Aristotle, the trained mind, *phronesis*, was the main virtue that made it possible for the noble gentleman to exercise other virtues – friendship, magnanimity, munificence, wealth, and high social status. In contrast with the New Testament belief, riches for Aristotle were a virtue and humility a vice. Before that, in Homeric times, virtue (*aretai*) meant excellence in physical strength and loyalty to the king without regard for the needs and feelings of other humans not of the kingdom. Nietzsche saw these radical changes in the meaning of virtue as the handiwork of powerful elites, in each case as a consequence of the human will-to-power instinct.

In the final analysis, Nietzsche called for genealogy to be life affirming. His great concern was not just to understand the way people narrate and explain their past, but more to evaluate the effects on their own lives. In reflecting on the value of historical narratives, he concluded that such knowledge should be the source of invigoration and action in the present, not merely “a costly super fluidity and a luxury” [Nietzsche, 1983, p. 59]. Genealogical history, then, was for Nietzsche, as well as for Foucault, a critical diagnostic of the present relations of power. As Mahon [1992, p. 101] sums it up, “Nietzsche’s genealogy, then, can be viewed as a diagnostic history of the present. The genealogist traces the history of the present in order to undermine its self-evidences and to open possibilities for the enhancement of life.” Foucault [1977] extended this idea, arguing that an historical event (such as a treaty, a reign, a battle, etc.) was not so much the cause of some change, but rather was the reversal of the relationship of forces, the usurpation of power. “The forces operating in history are not controlled by destiny or regulative mechanisms, but rather respond to haphazard conflicts” (p. 154). Two examples of genealogical, effective history follow.
WILLIAMS' GENEALOGY OF BRITISH DISCOURSE ON SLAVERY

Williams’ [1994] historical account of the radical shift in the British discourse regarding slavery in the Caribbean in the 17th and 18th centuries provides a vivid case in point. Williams followed the tenets of traditional history but also produced a genealogical critique of the currently prevailing view that humanitarian impulses were behind the abolitionist movement. He identified his primary sources in his bibliography (pp. 262-266), including Colonial Office papers; correspondence and memoranda of important people, such as leading statesmen; statistics compiled by ship captains; minute books of special government committees; and printed sources, such as the Hansard records of parliamentary debates and reports of special committees of the Privy Council. Williams’ bibliography also includes two kinds of secondary sources – contemporary and modern. These include material such as the writings of leading mercantilists; sundry pamphlet series; bibliographies of key figures; scholarly academic theses, essays, and lecture notes consisting of “careful analysis of original material” (p. 268); sundry “resources” in the British Museum and the Indian Office Library; Caribbean history books; comprehensive dictionaries; and even those novels which “reveal a profound understanding of the triangular trade and its importance to British capitalism” (p. 269).

Using these sources, Williams debunks the conventional moral progress historical account of Britain’s slavery in the West Indies and other parts of the Americas. His genealogy identified the discontinuity of British capitalism from mercantilist capitalism to technology and machine-based industrial capitalism with its accompanying radical rupture in Britain’s moralistic rhetoric regarding slavery when the industrial revolution’s captains of industry become England’s rulers. Williams’ genealogy shows how materialistic, economic considerations, not idealistic moral injunctions as is currently widely held, underpinned the radical reformulation of the British moral discourse regarding slavery. Thus, Williams’ genealogy served as a much needed, myth-slaying exercise.\footnote{Hobsbawm [1997, pp. 274-275] advocates myth slaying by historians in spite of the difficulties such endeavors entail.}

AN ACCOUNTING EXAMPLE

Macintosh et al. [2000] present a Baudrillardian-based gene-
alogy of the radical shifts in the accounting signs of income (i.e., profit) since feudal times to the present. Baudrillard identified three “orders” or eras of simulation (counterfeit, production or industrial, and simulacra) that followed the feudal period and four distinct phases of the sign to referent relationships that were typical of each era. In the feudal era, the sign was a reflection of a deep, solid reality. It was a “good” appearance in the sense that it is a faithful and transparent representation. This was also the case, Macintosh et al. [2000] argue, for accounting in feudal times where profit (income) reflected the net result of liquidation proceeds of separate ventures. This was profit in the true sense of the word rather than income, not a periodic calculation from continuing operations.

In the counterfeit era, the sign became an imitation of natural objects (like stucco and the emerging “midldin” class with its natural rights), and so it masked the absence of such a reality. The appearance of the non-terminal, joint-stock company (e.g., the British East India Company) led to the idea of the business as a going concern. The result was the introduction of nominal (not real) accounts in the form of accruals and deferrals, radically changing accounting technique. Accounting had entered Baudrillard’s order of the counterfeit with the sign of income becoming a counterfeit, an imitation of the feudal era’s liquidation proceeds. Henceforth, income signs could only play at being real. They no longer referred to a real, material economic territory.

This problematic relationship changed dramatically in the late 18th century with the appearance of the production or industrial era simulacra [Baudrillard, 1988, p. 137]. A whole new generation of signs-to-objects relationships accompanied the rise of the industrial revolution. The relationship between them was no longer either a good reflection of the object or a counterfeit of it. The key feature was the mass serial production of identifiable objects that had no equivalent in nature. The sign versus object relationship imploded, and it was no longer possible to differentiate between them. The object became the sign and the sign became the object. Absentee, depersonalized ownership came into prominence and accounting’s focus shifted from measuring the entrepreneurial proprietor’s return to a return to depersonalized capital. The income sign became a standardized, serially produced commodity in its own right, and its principal value was to facilitate the market exchange of

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12 See also, Macintosh [2005, ch. 4].
depersonalized capital. The income sign had slipped free from any original object.

The nature of the income sign experienced another radical rupture and reformulation with the advent of today’s order of simulation. Its chief characteristic is the production and consumption of signs (simulacra, images, models, etc.), which are detached from any real material realm. Instead, they circulate in the realm of what Baudrillard [1988] calls “hyper-reality” which has become more important in many respects than the real of real material objects. Regarding the income sign, investment analysts look to reports of income to predict a company’s future earnings. Simultaneously, the company’s accounting officers look to the analysts’ forecasts and “manage” reported income to meet these forecasts, and, in turn, the market capitalizes analysts’ earnings into stock prices. The company’s reported income, the analysts’ forecasting models, and the investors’ valuation models circulate simultaneously in the hyper-real financial realm in a Möbius strip-like fashion.

Yet, today, income reports, especially earnings per share, are treated as what in post-structural terms is called “the sign-of-signs” – a virtual “transcendental signifier.” Such a sign-of-signs/transcendental signifier refers to any concept that is taken to act as the foundation of a system of discourse and which forms the axis or hub around which all other notions and signs rotate and to which they refer. As Eagleton [1983, p. 131] explains, it is “the meaning of meanings, the lynch pin or fulcrum of the whole thought system of discourse, the sign around which all others would obediently reflect.” The income sign today is such a signifier. It is generally taken to be the most important piece of accounting information that organizations provide to the capital market and others. Capital markets rely on this sign, taking it to be a fundamental indicator of the underlying economic reality of the firm for use as an important signal when estimating the market value of the company’s stock. But, as Macintosh et al.’s [2000] research indicates, the income sign no longer refers to any “real” economic income or profit. Rather, it is a prime example of what Baudrillard [1988, p. 166] calls “the generation of a model of a real without origin or reality; a hyper-real in which the territory no longer precedes the map … it is the map that genders the territory.”

The upshot is that the financial markets are to an important extent ungrounded. McGoun [1997, p. 116] captures the idea in this fashion, suggesting that the stock market “is a hall of mirrors where reflections of reflections and images constitute
the only reality that matters.” In Baudrillard’s terminology, the financial market is a hyper-real economy that floats almost unconnected to the real economy of the production and consumption of goods and services, as well as unconnected to the real people who produce and consume these commodities. In this hyper-real economy, the income sign circulates detached from material objects and ideals, such as any true income of the enterprise. Given this view, the global capital market today is a free-floating phenomenon with no solid underpinnings. This genealogical research de-naturalizes and de-doxifies the generally held perspective of accounting reports of income, and, most importantly, it brings into the light this very strange and what should be worrisome state of affairs of accounting.

EARLY FOCAULDIAN ACCOUNTING STUDIES

The idea of genealogy as a means for critiquing the present, a vital strand in both Nietzsche and Foucault’s corpus of writings, however, somehow gets lost in much of the accounting history literature. The not insignificant body of published Foucauldian-type accounting historical genealogies is a case in point. A brief tour of some of the major cited papers along these lines provides support for this contention. This body of accounting research flourished in the mid-to-late 1980s and continues sporadically today.

A prime example is Loft’s [1986] genealogy of the rise of management accounting in the U.K. and the appearance of the Institute of Cost Accounting as a bone fide professional organization in the early part of the 20th century. Her research revealed how cost accounting arose to this status, not merely as technique for aiding decision makers, as the conventional view has it, but more as an important force in the British government’s discursive initiative to reconstruct Britain as an efficient nation with efficient firms and efficient workers. While her narrative is highly enlightening in this respect, it says little or nothing about the power effects of this use of cost accounting on the employees in British organizations. A number of other studies followed, taking their cues from Foucault’s surveillance, discipline, punishment, and normalization thesis and his excavation of the appearance of carceral techniques that spread throughout today’s institutions of all kinds. These studies, like Loft’s, however, come across as not only “un-Foucauldian” in tone, but also politically bland and lacking in critical edge.

Hoskin and Macve [1986, 1988], for example, traced the
“disciplinary grammatocentric” practices installed at West Point in the early 1800s and later taken on board seriously by the management cadres of U.S. railroads to the examining practices in the new, elite medieval universities. They concluded that these practices stemmed neither from market forces nor as an offshoot of financial accounting’s external reporting methods, as other historians such as Johnson and Kaplan [1987] would have it. Hoskin and Macve seemed almost to celebrate Foucauldian disciplinary practices, commenting that they both constrain and enable behavior. In another seminal study mobilizing Foucault’s power/knowledge disciplinary regimes of truth, Miller and O’Leary [1987] documented the appearance of the calculable worker-employee in the early part of the 20th century when standard costing and budgeting practices combined with the widespread instantiation of scientific management practices to render the individual constantly visible. They concluded that the “accounting gaze” enmeshed all in a ubiquitous web of calculative techniques, rendering them conspicuously visible while at work. The government at the time also embraced these practices with enthusiasm. Hopwood [1987] reported how management accounting and control systems in three different organizations actively shaped vital organizational practices rather than merely providing ex-post reporting. Preston [1992, p. 96] reported how hospital administrators in the U.K. mobilized accounting discourses to “impose a new economic order upon the medical.” The benign conclusions of these uncritical “critical accounting studies” are in retrospect strange given Foucault’s lamenting of the widespread adoption in western society of these carceral-like practices. Walsh and Stewart [1993], comparing the change in management practices between a woolen manufactory (1681-1703) and a cotton factory (1800-1812), drawing on Foucault’s [1979] panopticon notion, concluded that in the latter case, accounting (particularly cost accounting) played a fundamental role in the emergence of new organizational and managerial practices in controlling factory activities and the work force by and from a central office, and that “this role which accounting played in enabling the emergence of organization is fundamental to an understanding of accounting and the role it plays in organizations” [Walsh and Stewart, 1993, p. 799]. While Walsh and Stewart identify a radical change in management control practices, they appear to see it as progress. These works seem to be a far cry from Foucault and Nietzsche’s call for effective, genealogical historical research.

Moreover, critiques of such studies also are uncritical of
the contemporary widespread adoption of these practices. For example, Tyson [1990] convincingly challenged Hoskin and Macve’s contention that accounting controls were unable to attain disciplinary power over labor until a West Point-trained managerial component had been established at the Springfield Armory. Tyson’s careful documentation of prior events established that social and economic factors better explained the fundamental changes in accountability systems at the armory in the 1840s. However, as with Hoskin and Macve’s research, his critique provides no critical leverage on the widespread application of coercive, disciplinary surveillance and punishment in today’s factories, especially those in so-called emerging market economies.

In fact, such benign conclusions came as a surprise to Moore [1991], a critical literary theorist, who carried out an extensive review of the body of Foucauldian critical accounting studies, comparing them to critical legal studies. He concluded that while some provided a rich Foucauldian “account of accounting,” their deployment of Foucault’s ideas seemed blandly procedural.13 Moreover, and surprisingly for him, he also observed that they seemed to embrace the effects of power that came along with accounting controls in an unqualified and almost enthusiastic manner, depicting them “as a positive enabling organizing force” (p. 773). Moore criticizes Miller and O’Leary “who somehow miss the tyranny pursued into the tiniest details and can only conclude their paper by valorizing the current state of power in accounting” (p. 773).

Such sanguine Foucauldian research seems quite at odds with Nietzsche’s call for conducting genealogical research for the enhancement of the individual and society at large and with Foucault’s [1979, pp. 217, 228] observation that today, “We are much less Greeks than we believe. We are neither in the amphitheatre, nor on the stage, but in the panoptic machine … Is it surprising that prisons resemble factories, schools, barracks, hospitals, which all resemble prisons.” Elsewhere, he observes that all the carceral apparatuses have become a major function of today’s society (p. 304):

The judges of normality are everywhere. We are in the society of the master-judge, the doctor-judge, the educator-judge, the ‘social worker’ judge; it is on them that the universal reign of the normative is based; and

13 See Neimark [1990] for a critique of these studies that she labels as “neo-conservative.”
each individual wherever he may be may find himself, subjects to it his body, his gestures, his behaviour, his aptitudes, his achievements. The carceral network, in its compact or disseminated forms, with its systems of insertion, distribution, surveillance, observations, has been the greatest support, in modern society, of normalizing power.

Clearly, Foucault did not celebrate this eventuality. More recent research studies indicate that this benign tone has not changed much in two decades. Recent historical accounting research in Europe (especially in Italy, Portugal, and Spain) has witnessed a growing interest in Foucauldian-based studies, particularly by younger scholars. Hopefully, this essay will encourage them to take a more critical stance than the earlier studies discussed above.

RECENT EXAMPLES

The study by Busco et al. [2006] is a case in point. They provide an historical account of the 1994 takeover of the Italian state-owned company Nuovo Pignone (NP), a large engineering firm known for its quality products and profitability, by the giant, global multinational General Electric Corporation (GE). GE executives moved rapidly in what one NP executive later called a “blitzkrieg” attack to install the “GE Way” into NP, relying on three major initiatives. First, they installed GE’s exhaustive, comprehensive, and no-nonsense financial and management control system that extended from the top of the organization to the very bottom layers. (In fact, the first three GE executives to arrive at NP were the CFO, a high-level financial planner, and a corporate auditor.) Second, GE’s widely acclaimed Six Sigma program was rapidly instituted throughout NP. Third, GE executives initiated an intensive, company-wide retraining program at NP, similar to its well-publicized Crotonville training sessions in the U.S., including “waves of communication and training” that washed over the entire organization, focusing on financial and market performance at all levels. The financial controls shone

14 I am indebted to the co-editor, Richard Fleischman, for pointing this out to me
15 “The resources invested in NP to communicate the GE Way were massive, and the communication was endemic; ‘It follows you everywhere even in the toilet’ one employee reported” [Busco et al., p. 29]. Schein [2004], the well-known organizational culture theorist, compared the slogans and rhetoric of the Crotonville training to wartime brainwashing.
a spotlight on financial performance; the Six Sigma program focused on quality of operations; and the training programs aimed at instilling the GE Way and its values into all employees.

Busco et al. seem to celebrate GE’s *modus operandi* that produces double-digit increases in reported earnings every year. They conclude, “the new organizational practices based on the vocabulary of accounting and measurement ... contributed to the constitution and diffusion of a redefined sense of trust and security” (p. 38). In order to do so, they seem to “forget” the de-humanizing side of GE’s governance and controls. The GE Way included, for example, socially constructing each NP employee as either a “hi pot” (high potential) or “blocker” (those locals who impede change and who are dismissed). GE’s moral ethos was clearly articulated in other media in no uncertain terms by CEO Welch. His motto declared, “Control your destiny or someone else will.” Presumably, this someone else was Welch. A forceful injunction, “Change or Die” reinforced his shibboleth. Yet, employees feared being fired if any of its lines of business failed to be first or second in its industry. Moreover, “The GE Way of Life” demanded that managers be mean and lean, meet their numbers, improve operations continuously, achieve high growth in sales and profits, and not resist. These words betray GE and Welch’s staunch advocacy of neoclassical economics with its one-dimensional, self-interested, and atomistic behaving subject. GE’s managers and employees around the world, including those at NP, were deemed to be narrowly self-serving and utility-maximizing subjects, *homo economicus*. Busco et al.’s traditional historical account is totally void of any critical strand, whereas a genealogical approach would highlight the radical ruptures in NP’s social practices and conditions, exposing its dubious moral conditions.

The excellent, careful, and insightful accounting history articles about the Spanish Royal Tobacco Factory (RTF) circa mid-and-early 19th century by Carmona et al. [1997, 2002] and by Carmona and Gutiérrez [2005], documenting the disciplinary practices of the RTF, are instructive regarding effective history. In the first two articles, the authors seem almost to adopt a positive, progressive view of such practices: “These new spatial configurations, coupled with new administrative and accounting practices constituted a powerful regime of surveillance and control over space and operators/foremen” [Carmona et al.,

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16 See Tichy and Sherman, [1993], Stewart [1999], and Surowiecki [2000].
17 This is the title of the Tichy and Sherman book.
2002, p. 272]. They also conclude, “This influx of accounting practices which reached deeper into factory space than ever before demonstrates the remarkable powerful role that accounting practices can play in organizations” (p. 273). Carmona et al. [1997, p. 444] seem to endorse such practices: “Once available as a micro-technology [of discipline and surveillance], accounting opens up new possibilities through which work practices and power relations can be renegotiated and refined.” They do conclude, however, that, “the widely held contention that accounting is nothing more than a mundane and neutral technology ... is not only questionable but unsustainable.” As Sy and Tinker [2005] observe, however, such research ignores and thus erases the social conflicts of the past and present and does not constitute effective history.

Carmona and Gutiérrez [2005] provide an example of how accounting historical research can mount a critique of the present. They preface their article with an email exchange that exposes the Nike Corporation’s aversion to having its overseas suppliers referred to as “sweatshops.” The article goes on to document the RTF’s outsourcing production to Catholic orders of nuns reporting, “Our archival research reveals that the disciplinary practices were deployed across the various layers of the chain of command: nunneries were subject to surveillance through accounting controls” (p. 897). The article points out how the nuns then came under the gaze of two disciplinary regimes – the Church and the RTF (p. 900):

In summary, results from this investigation indicate that external sourcing of cigarette manufacturing to poor Catholic nuns was motivated by the juxtaposition of factors like the deterrence of gender conflicts within the RTF, exploitation of potentials enshrined in the disciplinary tradition of nunneries and prisons, and access to a cheaper labour force, as well as the political intention of the Royal House of signaling its partnership with the Catholic Church in the context of an absolutist regime. Such determinates, we argue, sharply contrasted with the discourse that motivated the concession of cigarette manufacturing to nuns on the grounds of royal compassion.

They conclude with a call for historical research that brings into the light the role of accounting as a public rationalization discourse that mystifies the power/knowledge surveillance and punishment mechanisms, especially accounting ones, embedded in management practices that are “increasingly applied in
today’s business” (p. 900). Their article illustrates how accounting history research can open up spaces for understanding how effective accounting historical research can de-naturalize and de-divinize the present widespread practice of outsourcing to exploit cheap labor locations around the globe.

CONCLUSION

This essay argued that accounting history research could benefit in relevance if more accounting history researchers presented critiques of the current state of authoritative accounting, GAAP, theory, and practice. The essay compared traditional history with Nietzsche and Foucault’s effective history and provided an example of the latter in the case of Nietzsche’s genealogy of the radical shifts over the centuries in the morals of western civilization. It presented two dramatic examples of effective, genealogical history. Williams’ genealogy of the shift in the moral discourse of slavery in Britain from the mercantile capitalism to the advent of industrial capitalism thus debunked the idea that abolition came about as result of high moral standards. And Macintosh et al.’s accounting example of the radical ruptures and shifts in the nature of accounting reports of income from feudal times to the present exposes the strangeness of current income reports. It offered a critique of some of the early Foucauldian genealogies of accounting and of a recent history by Busco et al. [2006] of GE’s dubious modus operandi in taking over companies around the globe. Surely, the massive muddle of IASB/FASB concepts and U.S. GAAP, as well as the dehumanizing gaze of management accounting systems, do not represent progress.

The essay concludes with a plea for traditional accounting historians to consider adopting genealogical, effective history as a way to mobilize critiques which challenge and refute the idea of progress in both financial and managerial accounting wisdom and practices. Such research efforts might open up spaces for new accounting vocabularies as proposed by Rorty [1989] and respond to Sy and Tinker’s [2005] call to address in a meaningful way the quandaries of present-day accounting. Clearly, capital-market (i.e., informational perspective) accounting researchers are not wont to address and critique the current state of accounting and the accounting profession, implicitly, at least, invoking the dictums and ideology of objective, neutral scientific epistemology. Such research continues to follow Ball and Brown’s [1968] decades-old call merely to investigate the as-
sociation of an accounting variable (e.g., abnormal earnings announcements) with an economic variable (e.g., abnormal stock market prices), drawing on very large computer data bases of accounting reports and security prices.

Accounting history research, in contrast, has the potential to launch critiques of the current state of accounting by adopting “effective” accounting history research. More than that, the task of genealogy “is to become a curative science” [Foucault, 1977, p. 256]. Effective history holds out the possibilities for such an eventuality. Finally, in the larger scheme of things, perhaps it is time to shift accounting’s discursive formations from the discourse of maximizing shareholder wealth to one of human solidarity and concern for community and an abatement of cruelty as Rorty [1989] advocates.

REFERENCES


Macintosh, Nietzsche’s Genealogical History


Academy of Accounting Historians
Margit F. Schoenfeld and Hanns Martin W. Schoenfeld Scholarship in Accounting History

The Academy of Accounting Historians invites applications for the 2009 Margit F. Schoenfeld and Hanns Martin W. Schoenfeld Scholarship in Accounting History.

The purpose of the scholarship is to encourage and support research on the history of accounting by doctoral students and recently appointed accounting faculty. The scholarship was initiated by the generous gift of Dr. Hanns Martin Schoenfeld and the late Dr. Margit Schoenfeld in recognition of their belief in the importance of historical scholarship to accounting education and research.

In 2009 an award of $3,000 is available to support research on a doctoral dissertation, or develop publications proceeding therefrom by a recent PhD graduate. Qualifying research topics should address the history of accounting. Projects of an international nature and those pursued by scholars whose first language is not English are particularly invited.

The recipient(s) of the scholarship will be determined by the Schoenfeld Award Committee, comprising the President of the Academy of Accounting Historians (Chair), the editor of The Accounting Historians Journal and Dr Hanns Martin W. Schoenfeld. The Committee has the capacity to share the award equally between two worthy candidates or to make no award in any one year.

Applicants must be currently enrolled for a PhD by research, or have completed a PhD by research within the last five years. Applicants should submit a full curriculum vitae and a statement (containing a maximum of 1,000 words) which discusses the doctoral research undertaken on the history of accounting, the stage reached and how the award would prove beneficial to the applicant. A short statement from a supervisor should also be submitted in the case of applicants currently enrolled for a PhD.

Applications should be submitted to: Cheryl S. McWatters, President, Academy of Accounting Historians, Alberta School of Business, University of Alberta, Edmonton, Alberta, Canada, T6G 2R6. Email: Cheryl.McWatters@ualberta.ca. The closing date for the receipt of applications is 31 August 2009.
INTERNATIONALIZING THE FRENCH AUDITING PROFESSION

Abstract: The objective of this paper is to trace the development of the French auditing profession, the commissaires aux comptes, focusing on the appearance of the large Anglo-American audit firms on the French market. The French audit market has always shown a number of peculiarities, including the continued importance of a number of local audit firms. The French auditing profession finds its roots in late 19th century company law that introduced an obligation for companies to release audited financial statements. The profession became regulated in its modern form in the 1960s. This paper attempts to explain the growing impact of the international audit firms on the French auditing profession. It also demonstrates how local professionals and the French state reacted to these developments.

INTRODUCTION

Most European audit markets have witnessed significant changes over recent decades. A striking development that has elicited academic curiosity is the growing impact of the large Anglo-American audit firms on local audit markets. The development of audit markets has been well studied in many venues, generally from an economic perspective using contracting theory as the framework for the analysis of developments in the supply of audit services [e.g., Watts and Zimmerman, 1983; Craswell et al., 1995; Holmes and Zimmer, 1998]. The existence of large accounting firms is partially explained by economies of scale. Summarizing the relevant literature, Meuwissen [1999] concluded that large audit firms obtain cost advantages and receive fee premiums, probably due to product differentiation.

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Part of this research focuses on audit-market concentration as the largest international firms have declined in number from the “Big Eight” to the now “Fat Four,” expanding their market shares in the process [Pigé, 2003; Ramírez, 2003]. One of the first studies in this area was Zeff and Fossum [1967], followed by others that also focused on the U.S. Moizer [1992] observed how European research lagged behind, that little academic work was done in the area of the European audit-services market in Europe previous to 1992.

Eventually audit-market structures were studied in, among others, the U.K. [Moizer and Turley, 1987], The Netherlands [Buijink and Maijoor, 1991], Denmark [Christiansen and Loft, 1992], Belgium [Weets and Jegers, 1997], and Sweden [Wallerstedt, 2001]. On the French market, Piot [2001] highlighted the barriers to competition between different categories of audit firms (the “Big Six,” large national firms, and local audit firms) on the basis of the characteristics of their client portfolios. Gonthier-Besacier and Moizer [2001] focused on the current perception of audit firms in France and found no significant differences between the “Big Five” and large local firms.

Most of the studies mentioned center on an analysis of empirical data relating to audit clients, fees, or number of professionals. Our objective, however, is to understand how and why the large Anglo-American firms became dominant in France, as in most other countries. The issue is worth pondering. Many consider France to be a country that vigorously defends its own culture, language, and modes of organization. The progressive introduction of the international firms means either that the French abandoned their traditional positions or that the international firms adapted to the French culture, language, audit approach, etc. These issues are explored in this paper.

LITERATURE REVIEW AND RESEARCH QUESTIONS

The research question of this paper relates to the entry and strategies of the Anglo-American audit firms in France. The literature on multinational firms distinguishes different modes of foreign entry. Anderson and Gatignon [1986] classified modes of entry based on the degree of control afforded the entrant. The highest degree of control is characterized by dominant equity interests, such as majority shareholdings. Medium-control modes include joint ventures and contractual arrangements and franchises. Low-control modes are typically non-exclusive contracts and minority shareholdings. Chan Kim and Hwang [1992]
demonstrate that entry-mode decisions are not only influenced by environmental and transaction-specific factors, but also by the global strategy of the multinational enterprise involved. Agarwal and Ramaswami [1992] consider ownership, location, and internalization advantages as factors that have an impact on entry-mode choice. To compete with local firms, foreign entrants must have superior assets and skills. These depend on firm size and the ability to develop differentiated products. The market potential and investment risk in the host country have an impact on both the decision to enter and the mode of entry. The strength of competition from local firms also influences entry strategy [Buckley and Casson, 1998].

The audit industry is a *service industry*. Much of the literature on multinational firms focuses on manufacturing enterprises and the debate over whether their conventions are applicable to service industries [Ekeledo and Sivakumar, 1998]. Because of the people-intensive nature of services, the entry-mode choices of service multinationals are more influenced by behavioral uncertainties, trust propensity, and asset specificity. Similar choices in manufacturing firms depend more on environmental uncertainties and risk propensity [Brouthers et al., 2002; Brouthers and Brouthers, 2003]. Sarathy [1994] concluded that the internationalization strategies in service industries are quite distinctive. They prefer direct modes of entry into foreign markets, through foreign investment and acquisitions, often with a local partner. High fixed costs and government regulations that favor local firms may deter service businesses from entering smaller markets. In such industries, implementing a unified strategy across different countries is a significant challenge. Bouquet et al. [2004] found that in industries where there is close interaction with end customers and where extensive levels of professional skills, specialized know-how, and customization are involved, there is a preference for wholly owned subsidiaries and expatriate staff. In business services such as accountancy, internalization and equity-based, foreign direct investment are the preferred modes for exploiting ownership advantages [Boddewyn et al., 1986]. These characteristics made it necessary to adjust the traditional transaction-cost framework used to study entry-mode choice [Erramilli and Rao, 1993].

Kipping [1999] studied the expansion of U.S. management-consulting companies to Western Europe in the 20th century. He concludes that the long-term success of consulting companies depends on the establishment of successful external (client) and internal (partner) networks. The success of U.S. consultancies
was linked with the aura of professionalism of U.S. industry and with the expansion of U.S. companies to Europe acting as a bridging function.

Previous research on the French accounting and auditing profession focuses on the development of associations of accountants in France between 1880 and the 1940s [Bocqueraz, 2000, 2001] and on the sociology of the accounting profession between 1920 and 1939 [Ramirez, 2001]. Ramirez [2003] relates the evolution of French auditors since 1970, as well as the role of the Anglo-American audit firms. He concludes that the success of these firms is due to their integration with the French elite and to the lack of adaptation of the traditional professional model to changes in the market.

RESEARCH METHOD

This paper is based on the analysis of a broad series of documents and archives, as well as on a series of interviews. These documents and archives have rarely been investigated. They consist of reports on the meetings of the Conseil Supérieur de l’Ordre des Experts-Comptables (CSOEC, National Council of the Institute of Public Accountants) from 1960, reports on meetings of the Conseil National de la Compagnie Nationale des Commissaires aux Comptes (CNCC, National Council of the National Association of Statutory Auditors) from 1970, and the archives of the Institut Français des Experts-Comptables (IFEC, French Institute of Public Accountants), a major trade union for French accountants from 1964.

The interviews provided information that was not found in any other source, as is often the case with oral history. The interviewees were selected on the basis of the role they played during the period studied and their functions in the audit profession. They include key players from the 1970s and 1980s – former presidents and directors of professional bodies, leading partners in international and local firms, and members of oversight bodies. The list of those interviewed can be found in Appendix A. All interviews took place in June and July 2002, and were attended by two of the authors. They were not taped, but extensive notes were taken and a report written by one author and checked by the other as close as possible to the interview date.

THE FRENCH AUDITING PROFESSION

The traditional audit function in France originated from company-law regulations in the third quarter of the 19th cen-
tury. Although oversight functions on behalf of the shareholders existed occasionally before 1863, the law of May 23, 1863 on limited companies introduced the statutory audit (the commissariat) in limited-liability companies. Article 15 of the 1863 law stated that the general assembly of shareholders had to elect one or more commissaires (auditors) who were required to submit a report on the situation of the company, its balance sheet, and the accounts presented by the directors. The auditor was called commissaire des comptes (auditor of the accounts), commissaire de surveillance (supervisor), or censeur (censor) [Houpin and Bosvieux, 1935, p. 291]. The 1863 law saw the commissaire as a company entity, similar to the board of directors, but with the task of auditing the books and analyzing the activities of the company [Foyer, 1971, p. 195]. As in other countries with similar systems, this auditing regulation was strongly criticized due to the lack of independence and competency regulations [Mikol, 1993, p. 4]. Shareholders, relatives of directors, or employees of the company were all eligible as auditors [Girardet, 1927, p. 104].

In 1935, the role of the auditor was clarified and his independence strengthened [Salato and Ghez, 1960, p. 25; Dupuis, 1967, p. 97; Mikol, 1993, p. 9]. A decree was issued on August 8, 1935, during an era of financial speculation and parliamentary corruption [Faure, 1929, p. 13]. It became impossible for directors, employees, or their relatives to serve as auditors. The provision of non-audit services to audit clients was not allowed; auditors could not receive any fees apart from an audit fee. They could only become directors after a five-year cooling-down period. The auditors had a mandate for three years and could not be terminated before the end of term. Other 1935 innovations included professional secrecy and the obligation to report illegal acts to the legal authorities [Kovarik, 1965]. In public companies, the position of auditors was further strengthened by introducing the requirement that at least one of them had to be chosen from a list of qualified auditors selected by the Courts of Appeal after an examination. But the function of commissaire was not restricted to specific professionals; most were experts-comptables (accountants), conseillers juridiques (legal advisers), or well-respected citizens. There was no specific auditing profession\(^1\); most of the commissaires had no accounting

\(^1\)Private initiatives to organize accountants include the Compagnie des Experts-Comptables de Paris, born in 1912. In 1927, the Ministry of Education created a state-recognized certificate for accountants [Mikol, 1993, p. 5]. After World
As late as 1967, external auditing was often considered ineffective [Chaput, 1990, p. 28]. Eventually, the auditing profession was comprehensively organized with the August 12, 1969 decree. This decree included a definition of the objectives of an audit and requirements with respect to entry examinations, independence, and professional secrecy. It led to the creation of the Compagnie Nationale des Commissaires aux Comptes (CNCC), a national body under the jurisdiction of the Ministry of Justice, contrary to the OECCA, the accountants’ professional body, which was linked to the Finance Ministry. Before this, there existed only regional Compagnies des Commissaires aux Comptes in each Court of Appeal district. They assembled in a federation, but this federation was not a real professional body under the authority and/or control of a ministry [interview 10].

One of our interviewees suggested that the creation of the CNCC was an attempt to create a more homogeneous body of experts, in contrast to the OECCA, whose membership was, by and large, considered incapable of performing audits [interview 3]. In fact, the OECCA complained that the state did not recognize the economic role that its members could play and, at the same time, the only profession that was organized on a legal basis was the accounting profession for whom an Ordre des Experts Comptables et des Comptables Agréés (OECCA) was created in 1942 [Salato and Ghez, 1960, p. 24]. Apart from the legally based OECCA, there were many associations for accountants and bookkeepers. (For a discussion of the development of the French accounting profession between the two World Wars, see Ramirez, 2001.) Although organized in the same body, the experts-comptables were opposed to the existing comptables agréés, a second-tier profession with little recognition. Interest in auditing was generally limited. Among the experts-comptables, the most advanced professionals were those working for judicial expertises. In fact, “most members of this profession were not involved in auditing” [interview 1].

The reform was prepared following the 1961 and 1962 OECCA congresses. The 1961 congress had been dedicated to standards on auditing and the definition of auditing, although this word was never used as such [interview 1]. Although almost no Anglo-American auditing firms or auditors were active in France at the time, the working parties of the OECCA who prepared the reform were strongly influenced by the methods and standards of such auditing firms and included a partner of Arthur Andersen France [interviews 1 and 2]. At that time, the only French firm that had formalized working standards was the Fiduciaire de France, possibly also the Fiduciaire de l’Est [interview 2]. One of the consequences of this lack of French practice was that the organization of the audit profession was to be based on the Anglo-American model. The draft company code of 1966 stressed that the auditors should “obtain the competency, independence, and prestige of the auditors of the Institutes of Chartered Accountants in the U.K., the members of the American Institute of Certified Public Accountants or the German Wirtschaftsprüfer” [Law Proposal 1003, May 6, 1965, Journal Officiel].
admitted being troubled by the tendency of the state to interfere in its internal problems [National Assembly, meeting on November 22, 1967, Journal Officiel, May 28, 1968, p. 773]. Because a significant percentage of the OECCA's members were at the same time commissaire aux comptes [Scheid, 2000; Bocqueraz, 2001], it is not surprising to find that it was common for the CNCC president to have held leadership positions in the OECCA. The OECCA and the bodies representing the commissaires also cooperated on a number of occasions.3

The first presence of the Anglo-American accounting firms in France probably should be understood from a transaction-cost theory perspective [Boddewyn et al., 1986]. By offering services in multiple locations, these accounting firms allowed their clients to reduce their international transaction costs. In other words, the auditors followed their clients. The historical sections of Anglo-American audit firms’ websites reveal that some of them arrived quite early on the French market. At least one was already present in Paris before 1914, due to the presence of American oil companies [interview 3]. Price Waterhouse established its Paris office in 1916. In 1960, it became the firm's major European office, with eight Anglo-American partners. Cooper Brothers, through its Belgian office, opened a Paris office in 1929. Due to the merger with Lybrand, Ross Bros & Montgomery in 1957, the Paris office became the first in the world to bear the name “Coopers and Lybrand.” An Arthur Young office was established in 1929. Andersen came rather late to France in 1952, becoming a full-member firm only by 1970. Until the end of the 1960s, it seems that the partners of these Paris offices were all Anglo-American; Price Waterhouse, for example, had its first two French partners only in 1969.

Although some of them were present early on, their impact on the French market was originally rather symbolic. They worked only with Anglo-American clients and their offices were small. The Price Waterhouse office in Paris, for example, em-

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3 For example, the general report presented at the 25th OECCA congress in 1970 was prepared by a working party consisting of OECCA representatives, the Institut Français des Experts Comptables (a major trade union group among accountants), the Institut National des Syndicats et Associations d’Experts Comptables et de Comptables Agréés (a secondary trade union among accountants), the Fédération des Associations de Commissaires de Sociétés inscrits (which became, in 1970, the Compagnie Nationale des Commissaires aux Comptes and still exists today) and the Compagnie des Commissaires de Sociétés Agréés par la Cour d’Appel de Paris (which, in 1970, became the Compagnie Régionale des Commissaires aux Comptes de Paris, still in existence) [OECCA, 1971, p. 2].
ployed less than 300 persons in 1975 [interview 1]. They do not seem to have been involved in statutory auditing before the end of the 1970s. To them, statutory auditing was apparently a legal formality, left to French professionals. One former president of the OECCA remembers that there were no Anglo-Americans at the beginning to assume the role of legal auditor (commissaire aux comptes) in French firms, nor were French professionals involved in contractual, non-compulsory audits for Anglo-American clients [interview 2]. This resulted in a clear market segmentation up to the 1970s; the international firms were involved in contractual audits or consulting services for subsidiaries of international companies [interview 3], whereas only French firms dealt with statutory auditing, which the Anglo-Americans viewed as “complicated, dangerous and difficult to understand” as it had a fundamentally legal consonance [interview 3].

In 1971, 5,171 commissaires were registered by the CNCC. Ninety-one percent of these worked as sole practitioners, and 87% spent less than half of their time on statutory audits [Bennecib, 2002]. Positions were not equally distributed; only 4.5% of auditors held at least 50 positions as statutory auditors. Eighty-four firms acted as statutory auditor for 80% of all listed companies. The vast majority of French professionals were sole practitioners who ran their offices in a very “traditional” way – no engagement letters, no analysis of internal control procedures, no confirmations, no physical inventories, etc. One of their major weaknesses was their dispersion. This situation was further complicated by the heterogeneity of the French profession. Not only was it divided between the OECCA and the

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4 Quite early on, the accounting profession attempted to educate its members in the field of auditing. As early as 1965, the 20th OECCA congress resulted in the publication of a textbook, *Auditing: Theory and Practice of the Control of Financial Statements* [OECCA, 1965]. This textbook was distributed among its members in an attempt to improve practice. Contemporary audit methods seem to have been known in France in the 1960s and 1970s, even though they were not used by the vast majority of French practitioners. In fact, even in 1970, the OECCA summed up a number of techniques that were not often used in French auditing – evaluation of internal controls, establishment of an audit program and extensive working papers, statistical sampling methods, and direct confirmations of account balances [OECCA, 1971, p. 3]. The professional body also tried to have an impact on education. In this area, there were initiatives by the profession and higher education institutions, especially in the area of audit education. Up to 1970, accounting was barely taught at universities, but before that year, it was already part of the programs offered in vocational schools and in a growing number of Grandes Ecoles business schools [Casta and Mikol, 1999].
CNCC, but also within the major bodies, there were tensions between comptables agréés and experts-comptables [Mikol, 2004, p. 9]. International audit firms, on the other hand, had aggressive growth strategies. They were constantly looking for alliances and strategies that could give them a competitive advantage [Stevens, 1991].

In the 1970s, all of the “Big Eight” international accounting firms were present in France [Bennecib, 2002]. Their French offices were legal entities according to French law, registered with the OECCA. At that time, their majority shareholders were either French citizens registered as experts-comptables or commissaires aux comptes, or foreign nationals having resident status in France with the same professional qualification [Colasse and Pavé, 2005]. The arrangements within the international networks of firms were diverse. Generally, they were partnerships. In some, there was a centralized structure with branches in different countries. In others, there was a more federal structure where the local firms had exclusive rights to use the brand name and where contractual arrangements between the international and the national levels included an obligation to train staff according to a defined methodology and to collaborate with other network firms, as well as potentially receiving sanctions if a local firm abandoned the network.

The Aubin report [1982, §64], a major governmental report on the status of the profession, summarized the situation at the end of the 1970s as follows: “The atomization of practices that damages the coherency and quality of their services; the increasing power of the Anglo-American practices, supported by a clear strategy of market entry and massive resources.” In such circumstances, conflicts between the different sectors of the profession became unavoidable.

**FRANCE AND INTERNATIONALIZATION**

Internationalization strategies of companies are strongly influenced by institutional factors. Decisions on entry modes are influenced by attempts to gain legitimacy from internal and external claimants. Yiu and Makino [2002, p. 667] argue that “choices of foreign entry mode are significantly influenced by isomorphic pressures embedded in foreign national environments.” Multinational firms face pressure to conform to the standards and values of the host country and to the practices within the multinational enterprise. Their behavior is influenced by regulative, normative, and cognitive aspects of the institut-
tional environment. Institutional distance refers to the extent of dissimilarity between host and home institutions [Xu and Shenkar, 2002]. A large institutional distance hinders the transfer of organizational practice from the parent to the foreign subsidiary. This is relevant for this paper as the culture of the international audit firms was mainly U.S.-based, which might have made entry into France more difficult.

The attitude of France with respect to U.S. business innovations has been analyzed comprehensively by Djelic [1998]. This section summarizes some of the key developments that she identified. Before World War II, France was a country of small companies; large firms were concentrated in only a few industries, such as mining or iron and steel. French firms were typically individual or family-owned. Private limited companies and partnerships were far more popular than public companies. In France, little trace could be found of the managerial revolution that changed much of the U.S. industrial structure at the same time. In fact, developments in the U.S. were generally met with fear and dismay and were considered incompatible with the French economic and social order. World War II changed this pattern significantly. France emerged from the war as a weak and divided nation. Large parts of the population questioned existing traditions and institutions. A dynamic economic system came to be seen as a basis for geopolitical power. The examples of the U.S. and the U.S.S.R. became attractive for their emergence as great powers that relied on innovative and growing economies. Following the war, cross-national networks were created linking small groups of powerful French technocrats and progressive Americans, generally associated with the Marshall plan. Examples include Jean Monnet, Pierre Mendès-France, and the newly founded Ecole Nationale d’Administration. They started a modernization process of French industry to increase productivity, often with the American economy and U.S. managerial knowledge and methods as references.

This context made the introduction and growth of the Anglo-American auditing firms in France easier. Our respondents indicated that the Anglo-American firms enjoyed a young, modern, dynamic, and competent image. This positive image was felt to affect the company managers who hired these firms as auditors. They had a good reputation due to their methodological advantage [interview 2]. They were seen as “modern and chic” [interview 3]. This view was confirmed in the professional journals: “We also observe a growing fad for Anglo-American techniques”
The international firms had a stronger financial position than French professionals because they were really firms rather than loose groupings of professionals [interview 2]. Due to their stronger financial position, they were able to take over attractive clients from retiring French professionals [interview 6]. It seems that they also could charge higher fees (the ratio was from 1 to 100 compared to a French firm, according to interview 2, based on a certain kind of “snobbism at a time of prosperity” [interview 3]. Contrary to this, one of our respondents indicated that the Anglo-Americans “low balled on audit fees to get an introduction to a client, and then made money out of consulting” [interview 5]. However, this is difficult to confirm because audit and non-audit fees were not disclosed in France until recently. Anyway, higher fees would be consistent with the observation in the literature that “multinational firms should have superior assets and skills that can earn economic rents that are high enough to counter the higher cost of servicing these markets” [Agarwal and Ramaswami, 1992, p. 4].

International firms were well-organized, focusing on audit methodology and efficient use of staff. Previous research demonstrates that most traditional French commissaires approached the verification of financial statements from a narrow, legalistic perspective [Ramirez, 2001]. The international firms, on the other hand, adopted a more modern and comprehensive approach. It was well known that there was a large gap between French audit practices and those in the Anglo-American and Germanic countries [Law Proposal 1003, June 20, 1964, p. 696]. The professional competency of the Anglo-American firms was undeniable [interviews 5, 6, and 9], and they used tools that the French auditors did not have [interview 6]. The only exception seems to be the Fiduciaire de France which remained an innovative firm until the 1980s [interview 8]. The international firms were perceived to be more serious [interview 2] and provided their clients with the presence of numerous assistants, making their work visible and valuable. Their files were full of working papers, which was not always the case for French firms [interview 6]. From a methodological point of view, they had an edge over most French professionals [interviews 2 and 3] and guaranteed the quality of a homogeneous service [interview 3]. The Anglo-American firms demonstrated their methodology also to a broader audience.

The increasing internationalization of French companies from the 1980s onwards further strengthened the position of
the Anglo-American audit firms. French audit firms apparently could not offer overseas services to the same extent, and their names were not recognized abroad [Casta and Mikol, 1999, p. 114]. Although some French firms tried to establish networks of correspondents (e.g., Salustro and DFK in 1966), the Anglo-American networks proved much stronger because they were more integrated and had existed for a longer time [interview 2]. French firms definitely suffered from a competitive disadvantage because the major positions, e.g., in the U.S. market, were already taken by home-based firms there [interview 3]. Using the signature of international audit firms allowed French companies to gain recognition abroad [interviews 6 and 7].

The international firms also offered a broader range of services. In France, the market for non-audit services was completely open. During the 1970s and 1980s, the local audit firms had “nothing else to sell but accounting or taxation consultancy,” with the exception of Fiduciaire de France, which also offered legal expertise. International firms systematically sold a broad range of services [interview 6], including computer services (a key area for Arthur Andersen according to interview 3), tax consulting, recruitment consultancy, corporate finance, and environmental consulting. Their competence was overwhelming in the field of “real consulting, that is, one that leads to setting procedures and information systems,” and which allows the sale of thousands of hours of services [interview 5]. Often they got a foothold in companies by offering tax services, especially those related to international tax issues, and then extended their involvement [interview 7]. The timing of their large-scale introduction to the French market coincided with the prevalence of huge opportunities in this area. They also provided specialist services, such as consolidation. French professionals were unfamiliar with group accounts. The term “consolidation” does not appear in the 1957 Chart of Accounts (Plan Comptable), neither does it appear in accounting teaching curricula nor in the July 24, 1966 law on commercial firms [Casta and Mikol, 1999]. Although the first consolidated statements predate 1968, the practice was not widespread, and reports were prepared without legal or professional rules [OECCA, 1971, pp. 133-159]. The Anglo-American firms immediately dominated this part of the market; large groups, such as Saint Gobain, depended strongly on international audit firms, in part because their consolidated statements

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5 Of the capital of French companies listed on the Paris Stock Exchange, 37.5% was owned by foreign investors as of 2000 [Le Monde, 2001, p. 22].
generally adopted American accounting standards. Consolidated financial statement regulations were eventually introduced into the French law in 1985 [Touron, 2003].

INSTITUTIONALIZING THE INTERNATIONAL AUDIT FIRMS

The Reaction of the French Public Authorities: In 1982, Minister of Finance Jacques Delors commissioned Finance Inspector Christian Aubin [1982] to conduct an investigation into the accounting profession. According to one of our interviewees who personally participated in its elaboration, this study was mandated by the profession itself [interview 3]. It suggested the easing of regulation on the provision of non-audit services and the creation of a new body of larger audit firms that would be internationally recognized. The position of the French government was also expressed during the parliamentary debate: “The objective of the government … is to facilitate the development of French firms that have a professional level and a size that allows them to offer quality services which are comparable to those of their international competitors” [Senate Debates, November 20, 1982, Journal Officiel, p. 5,624].

The Aubin report was followed by an initiative by the minister of finance, approved by the minister of justice, who asked Inspector General of Finance Philippe Huet to propose measures to strengthen the audit profession in France and to help it in its international development. However, Mr. Huet concluded in 1984, that it was only through joining worldwide audit firms that French auditors would have their professional quality recognized internationally. Starting with such associations, French firms could become famous and then continue on their own [Aujourd’hui et Demain, No. 28, June 20, 1984].

All these reports suggest that the position of the French State was to conclude that mergers within the accounting profession were unavoidable. Smaller firms apparently saw this as an attempt to stimulate the creation of large audit firms, to the detriment of small firms and sole practitioners, and blamed the state for helping the Anglo-American firms. One of our respondents averred that the state has “done nothing to help the French profession” and even “has an absolute responsibility” for weakening the position of French professionals [interview 3]. The same message was communicated in the editorial of L’Expert-Comptable de Demain [July 1983, p. 3]: “Mr Aubin concluded that, faced with competition and in order to be able to invest in research, our profession is bound to merge ... M. Aubin
seems to think that great size is the necessary and sufficient condition for making a professional firm credible. This is not our opinion.” This mistrust of the role of the state was already present among practitioners in the 1970s. As an example, Jacques Secher said at the general meeting of the IFEC on November 4, 1972: ‘The main enemy are the Public Authorities and a number of technocrats who want to abolish the professions, the medical doctors, the barristers’ [cited in IFEC Informations Mensuelles, November 1972, p. 31]. To some extent, this type of reaction reflected a development that goes beyond the world of accounting. It represents a transformation from a profession focusing on its institutional role to one in which business interests became much more significant. During this period, French notaries, architects, and doctors, confronted with similar changes, questioned their professional organizations.

The Role of the Commission des Opérations de Bourse: The Commission des Opérations de Bourse (COB) was created in 1967 to supervise the French capital market. It could have had a significant impact on the introduction of these international audit firms since it ratified the appointment and renewal of statutory auditors in listed companies. Although the COB did not have any decision-making power, companies often asked its opinion when audit mandates had to be renewed. Evidence with respect to the role of the COB is contradictory. Generally, it increased the demand for competent and independent auditors [interview 1]. Some of our respondents suggested that the COB had a list of auditors that it recommended to companies desiring a listing [interviews 2 and 4]. This view was rejected by the former head of accounting policy at the COB [interview 7]. For some, the COB apparently preferred the French audit firms because its contacts with such firms were easier and because it had more impact on them [interview 2]. However, other respondents stated the opposite, suggesting that the COB preferred the Anglo-American firms because they were more fashionable, more competent, and/or more dynamic [interviews 3, 5, and 6]. Other respondents said that the COB was not very concerned [interview 9] or that its position varied depending on the preferences of its president [interview 4]. On balance, the COB on this issue appears to have favored larger audit firms. It confirmed that the certification of financial statements should be based on an audit

6 The COB is currently known as the Autorité des Marchés Financiers (Financial Markets Authority).
(une révision comptable) by commissaires with a team of assistants, carried out during the accounting period, and supported by a permanent file, including an analysis of the internal control system [Meary and Salustro, 1971, pp. 176-177]. This position went contrary to the approach of the traditional French commissaire, who often worked individually [Ramirez, 2003]. There is no factual evidence of a clear position taken by the COB. During our interview, the former COB executive showed that French audit firms audited 45% of the medium-sized firms listed on the Second Market, created in 1987, and all of the companies listed on the New Market, created for high-tech firms in 1997. In conclusion, it is unclear which firms were favored by the COB, and whether there was any systematic pattern in its preferences. Its role should not be overestimated, in any case, because the French stock market was only of secondary importance and many large French companies were state-owned.

In the 1980s, the big Anglo-American firms came to dominate the whole of the French audit market, as shown in Table 1. Among 591 audit firms employing more than 20 persons in France in 1983, only ten had more than 200 employees, representing one-third of the profession in terms of personnel. Just nine of them audited 48.3% of French listed companies. A decade later, audit firms with more than 50 staff employed only 1.3% of French auditors and accountants, but earned more than 29% of the total revenue of the profession in 1997 [Béthoux, 2001]. A number of local firms continued to audit listed companies, although the vast majority of companies on the stock exchange were audited by international firms.

**TABLE 1**

**French Audit Market in 1983**

**Panel A: Turnover of French Audit Firms in 1983, French Francs, (000s omitted)**

<table>
<thead>
<tr>
<th>Rank</th>
<th>Audit Firm</th>
<th>International Network</th>
<th>KF</th>
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<tbody>
<tr>
<td>1</td>
<td>Helios Streco Durando</td>
<td>Arthur Young</td>
<td>186,000</td>
</tr>
<tr>
<td>2</td>
<td>Guy barbier et associés</td>
<td>Arthur Andersen</td>
<td>115,000</td>
</tr>
<tr>
<td>3</td>
<td>De Bois Dieterlé et associés</td>
<td>Touch Ross</td>
<td>95,700</td>
</tr>
<tr>
<td>4</td>
<td>Gufflet et Cie</td>
<td>Coopers et Lybrand</td>
<td>90,000</td>
</tr>
<tr>
<td>5</td>
<td>Blanchard Chauveau et associés</td>
<td>Price Waterhouse</td>
<td>85,000</td>
</tr>
<tr>
<td>6</td>
<td>Audit continental</td>
<td>Peat Marwick Mitchell</td>
<td>73,000</td>
</tr>
<tr>
<td>7</td>
<td>Befec</td>
<td>B.D.O.</td>
<td>72,000</td>
</tr>
<tr>
<td>8</td>
<td>Frinault Fiduciaire</td>
<td>K.M.G.</td>
<td>69,800</td>
</tr>
<tr>
<td>9</td>
<td>SEEC Reydel Blanchot</td>
<td>Dunwoody Robson</td>
<td>58,000</td>
</tr>
<tr>
<td>10</td>
<td>Cabinet Mazars</td>
<td>N/A</td>
<td>52,000</td>
</tr>
</tbody>
</table>
Panel B: Audit Firms with the Highest Number of Listed Clients

<table>
<thead>
<tr>
<th>Rank</th>
<th>Audit Firm</th>
<th>International Network</th>
<th>Number of Listed Clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Befec</td>
<td>B.D.O.</td>
<td>155</td>
</tr>
<tr>
<td>2</td>
<td>Frinault Fiduciaire</td>
<td>K.M.G.</td>
<td>121</td>
</tr>
<tr>
<td>3</td>
<td>De Bois Dieterlé et associés</td>
<td>Touch Ross</td>
<td>108</td>
</tr>
<tr>
<td>4</td>
<td>Helios Streco Durando</td>
<td>Arthur Young</td>
<td>100</td>
</tr>
<tr>
<td>5</td>
<td>SEEC Reydel Blanchot</td>
<td>Dunwoody Robson</td>
<td>58</td>
</tr>
<tr>
<td>6</td>
<td>Calan Ramolino</td>
<td>DHR International</td>
<td>53</td>
</tr>
<tr>
<td>7</td>
<td>Castel Jacquet</td>
<td>N/A</td>
<td>50</td>
</tr>
<tr>
<td>8</td>
<td>Fiduciaire de France</td>
<td>KMG</td>
<td>51</td>
</tr>
<tr>
<td>9</td>
<td>Pavie et associés</td>
<td>N/A</td>
<td>51</td>
</tr>
<tr>
<td>10</td>
<td>Cauvin Angleys St Pierre</td>
<td>Howard et Howard</td>
<td>39</td>
</tr>
</tbody>
</table>

Source: ATH, 1985

OPPOSITION AGAINST THE INTERNATIONAL FIRMS

The Cultural Reaction: Following World War II, not everyone in France was convinced of the need to modernize the French economy. Part of the French business community has always continued to defend its traditional positions against the modernizers [Djelic, 1998, p. 237]. French business associations were divided with many of its members suspicious of the modernization project. Especially in smaller companies, there remained strong support for traditional family capitalism in the 1950s. This conservatism limited the potential growth of the Anglo-American audit firms in France. In general, multinational corporations are hindered in their expansion if there are significant legal or cultural differences between home and the target country [Xu and Shenkar, 2002]. The differences between France and the Anglo-American countries, home to the large accounting firms, were quite significant [Nobes and Parker, 2000].

A legalistic tradition is a major component of French society, leading to a “highly regulated position of statutory auditors” [Piot, 2001, p. 463]. Specific French attributes, such as the strict regulation of independence and requirements in corporate law to issue specific reports to third parties, may have produced a significant barrier to the entry of Anglo-American firms into the auditing market. Another significant issue is the role of French culture and its impact on the business community. Antinomies between French and the Anglo-American cultural models made the Anglo-American model ill-adapted to French behaviors [d’Iribarne, 1985]. Traditional preferences for “French products”
also helped the French accounting firms, especially in small companies (culture franchouillarde or “Frenchy culture”), as one of our respondents put it [interview 2]. Those who resisted the introduction of Anglo-American firms strengthened this protectionist cultural attitude. Those cultural and regulatory barriers appear to have been quite strong. As indicated before, the Anglo-American firms originally established themselves with non-French partners, illustrating the American preference for majority ownership in foreign subsidiaries [Erramilli, 1995, p. 228]. It is probably also linked with their limited target market (subsidiaries of foreign companies) and with the relatively small number of French professionals who could meet their standards in these early years. To overcome the limitations that this policy placed upon their growth potential, their strategy adapted to French culture and regulation and the international firms became rapidly “francized.” They began to hire French professionals and promote them to the partner level; “they adapted marvelously to the French environment by hiring French professionals very rapidly” [interview 5]. More generally speaking, it suggests that these firms gradually adopted a strategy of licensing or franchising once a sufficient number of knowledgeable professionals was present in the French market [Boddewyn et al., 1986].

The Reaction of French Professional Bodies: As with other industry associations, the professional accounting bodies defended the interests of French professionals. The accounting activities of foreigners were strictly regulated. Based on a September 1945 regulation, foreign professionals could be allowed to provide accounting services in France. However, their number remained quite limited. 7 Our interviews suggest that official representatives of the profession often were against the development of the large Anglo-American firms in the early 1970s [interview 2].

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7 Some examples show these low numbers. Fifty-eight Swiss professionals and ten professionals labeled as “refugees” joined the profession in 1959. The “refugees” probably came from former French colonies; they definitely were not Anglo-American [Actes du CSOEC, February 10, 1960]. In 1960, 60 Swiss and 11 “refugees” [Actes du CSOEC, February 6, 1961] and in 1961, 60 Swiss, 17 “refugees,” and 4 professionals from Morocco were accepted as members [Actes du CSOEC, February 14, 1962]. In 1971, some U.K. professionals were accepted by the OECCA, but the following year, another candidate was rejected. The report on the meeting of the OECCA board that discussed the rejected candidate’s application mentions intense discussions on the subject of “tolerated professionals,” presumably referring to the Anglo-American accounting firms.
This opposition was not only a nationalist reaction, it was also a reflection of what perhaps could be labeled as a more traditional view of the accounting profession. Jean Sigaut, president of the CNCC between 1975 and 1979, for example, considered both the Anglo-American firms and large French firms, such as the Fiduciaire de France and La Villeguérin (a multiservice firm), to be breaking professional rules with respect to combining statutory audits and advisory services.

A number of measures were taken that made it more difficult for the Anglo-American firms to grow. Auditors could only practice as commissaire under a French name. This was a serious handicap for the international firms since the use of their international trademarks would have given them a significant ownership advantage over lesser-known competitors [Boddewyn et al., 1986, p. 50]. Some of them, such as Arthur Andersen, tried to register under French names. Others were registered as “foreigners” and prevented from conducting statutory audits [interview 3]. A second measure that acted in fact as a barrier to Anglo-American firms was a ban on publicity. In 1984, advertising was allowed for audit firms in the U.K. [La Profession Comptable, November 1984], leading to a multitude of advertisements in such newspapers as The Financial Times. It was followed by debates in France because the liberal U.K. policy created distortions in the market as the continental branches of the international audit firms obviously profited from those campaigns.8 Third, the regulation on accepting trainees stated that one could spend only one year of the three years of traineeship in a foreign firm to become qualified for membership in professional organizations [Aubin, 1982, §111]. One of the consequences of this limitation was that a number of professionals from the Anglo-American firms moved to large French firms. One of our respondents cited the case of approximately ten promising, young auditors who left Peat Marwick, were hired by Mazars for their training period, and remained there afterwards [interview 1].

The limitations on combining different types of services were supposed to prove more cumbersome to the Anglo-American firms. As a consequence of disciplinary actions, these firms created separate entities for each of their activities. Peat Marwick, for example, created PMM France (consultancy), Audit Continental (accounting), Agence Juridique et Fiscale (law), and SCP Claude Briollay (auditing) [Aubin, 1982, §113.] However, the

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8 Advertising for audit firms was only allowed in France in 2005.
French State, had it really wanted to, could have done more to limit the expansion of the international audit firms. It did not prosecute the international firms for violating conflict-of-interest regulations, probably because the CNCC never initiated legal actions on these issues. Jean Sigaut, president of the CNCC, declared at the general meeting of the Compagnie Régionale des Commissaires aux Comptes de Paris on July 10, 1979, that the CNCC did not want to take action because that would have publicized the problems of the profession and would have damaged the whole of the profession. Another reason was probably that the Anglo-American firms were not alone in offering multiple services. Large French firms such as Fiduciaire de France and La Villeguérin did the same [IFEC Archive, IFEC General Meeting, October 23, 1971], and many sole practitioners also offered different types of consulting to their auditing clients [CNCC Archive, CNCC National Council, July 10, 1972; CNCC Archive, General Meeting of the Compagnie Régionale des Commissaires aux Comptes de Paris, July 10, 1979]. If the profession had gone against the international firms, it would have to take action also against local practitioners.

It seems that the professional bodies were stuck between their traditional defense of the French profession and the need for stronger auditing firms. René Ricol, at that time president of the CNCC, confirmed in 1987 that the first objective of the CNCC was to support the development of French audit firms capable of providing services to French clients abroad [La Profession Comptable, No. 54, June 1987]. The second objective was to provide a French identity to international firms with French branches that would be as independent as possible from international networks. Ricol [as cited in La Profession Comptable, No. 54, June 1987] analyzed the situation as follows:

... I am referring to the clear evolution of some major international networks towards a federative structure, in which strong national firms regain their independence. I continue to hope to see one or two French audit firms capable of creating a smaller, less ambitious network that would be entirely at the service of France. ... The real debate nowadays is for the medium and small sized firms who have to devise their strategy. This choice is either a local client base, the voluntary decision to join a federation, or a restructuring of audit firms.

*The Reaction of French Professional Associations:* Professional associations also reacted to the developments but were divided
on the issue. Some, such as the Experts-Comptables de France (ECF), defended the small firms; others, such as the IFEC, favored international firms [interview 4]. An interesting initiative was the creation of the AFDA, the Association Française pour le Développement de l'Audit (French Association for the Development of Auditing). According to Le Nouvel Economiste of February 15, 1982, the AFDA was a lobbying instrument, set up by the public authorities after the election of François Mitterand as president of France in May 1981 and the OECCA, in order to support the large French accounting firms in their negotiations with the French administration and those responsible for the management of the public sector. The AFDA was supposedly introduced to stimulate the election of large French firms as commissaire aux comptes to the detriment of the large Anglo-American firms and the smaller French auditors [L'Expert-Comptable de Demain, May 3, 1982]. The creation of the AFDA led to diverging reactions from the profession. It was immediately criticized by a significant number of sole practitioners who considered the AFDA to be an initiative to conquer their traditional market: “I have written that the AFDA is a scandal and I have said it openly: the AFDA is a group of people who reserve the business for each other” [Franc Parler, No. 33, 4th quarter, 1984, quoting J. Sigaut]. Others said that it “became a closed group with a corporatist attitude whereas it should be an instrument to promote quality” [Franc Parler, No. 18, 2nd quarter, 1982, quoting J. Caudron], and that it was created to “reserve part of the accounting market for a limited number of audit firms” [L’Expert-Comptable de Demain, June 6-7, 1982, quoting Maranchon]. However, the AFDA also had its supporters within the profession because it could help maintain the presence of French firms as auditors for large clients [L’Expert-Comptable de Demain, June 6-7, 1982; Aujourd’hui et Demain, No. 7, June 15, 1982]. Guy Cosson summarized the strategic role of the AFDA as follows: “The AFDA is not only a battle machine between the large French firms against the large Anglo-American firms, for the large auditing assignments; it will also (I do not dare to say mainly) be a tool to speed up the concentration of engagements for the large firms” [L’Expert-Comptable de Demain, October 1982]. In conclusion, the AFDA was created with the support of a few large firms to put into place a structure capable of fighting the Anglo-American firms by co-opting their very own methods, such as high-quality services, a large and competent staff, and systematic quality control. Its creation in fact confirmed that the Anglo-American accounting firms were considered to have
superior assets and skills that allowed them to compete successfully with local competitors [Agarwal and Ramaswami, 1992]. Their superiority apparently was considered such that mimicking them seemed to have become the only viable alternative for part of the French profession and the state.

The Importance of French Legal Joint-Audit: The co-commissariat was another support for the traditional profession. To strengthen the protection of public savings, the August 8, 1935 decree had forced listed companies to select at least one of their commissaires from a list maintained by the Courts of Appeal. These auditors were selected on the basis of an examination of their technical competency. Thirty years later, the law of July 24, 1966 maintained the obligation to have two commissaires in listed companies and in private limited-liability companies possessing a capital of more than five million francs. However, all commissaires had to meet the same minimum quality standards from 1966, and the introduction of the Eighth European Directive in 1984 further harmonized the level of professional competency. This means that the original obligation to have two auditors, one of them having a guaranteed professional competency, became meaningless. The existing regulation was criticized by the COB, the financial market regulating body: “The unity of the audit methodology and of professional responsibility ... seems incompatible with collegiality” [National Assembly, Report 1526, May 26, 1983, quoting Jacques Roger-Machart]. Industry, represented by its Paris lobbying body, the Chambre de Commerce et d’Industrie de Paris, also criticized the regulation: “...the only consequence of the obligation for certain companies to employ two commissaires is that they have to pay additional fees” [CNCC Archive, CCIP press release, April 2, 1971]. The CNCC continued to support the co-commissariat: “...facing directors who – in this type of companies – are often eminent personalities, the presence of two commissaires who support each other increases significantly the importance given to their opinions and their capacity to resist pressure from the directors” [CNCC Archive, Jean Sigaut, in a letter to the director of the exchequer, March 10, 1976]. Other advantages, according to CNCC officials, were that young professionals could audit large companies with the help of experienced commissaires and that the system generated additional fees [CNCC Archive, letter from Roger Caumeil, president of CNCC, to Representative Roger-Machart, June 30, 1983]. Caumeil believed that the suppression of the co-commissariat would lead to the replacement of French auditors by Anglo-
American firms [\textit{CNCC Archive}, letter from Roger Caumeil to Robert Badinter, minister of justice, January 17, 1984]:

Now that we introduced the obligation to have the consolidated financial statements audited, suppressing the \textit{co-commissariat} would lead the large companies (that have international financial operations and consequently need the signature of an international audit firm), to keeping only the French branch of international firms as their auditor. Consequently, many French \textit{commissaires} would be eliminated and the largest companies would be audited by international firms. The \textit{co-commissariat} allowed the French auditors to maintain their position up to now and even to increase their market share in auditing.

Eventually, the discussions during the first half of the 1980s maintained the \textit{co-commissariat}, even though the law of March 1, 1984 focused its application on companies that published consolidated financial statements. In conclusion, the \textit{co-commissariat} was seen as a way to oppose the dominance of the Anglo-American firms and to defend the interests of the auditors in large companies. Eventually, also, the \textit{co-commissariat} would not be able to prevent the growing impact of the international audit firms, which extended their impact on listed and other large companies through mergers in the early 1990s.

\section*{GROWTH STRATEGIES OF THE INTERNATIONAL AUDIT FIRMS}

The Anglo-American firms in France followed different growth strategies. The majority experienced internal growth coupled with the takeover of local firms, a more efficient and less costly strategy than creating new offices [\textit{interview 9}]. Mergers with local French firms were seen as a way of overcoming French resistance against an Anglo-American takeover [Gonthier-Besacier and Moizer, 2001].

One example is Arthur Andersen. It began its activities in France by following clients with activities in Europe. In December 1970, the firm abandoned its international name to become \textit{Guy Barbier}, adhering to a regulation of the OECCA that required the use of a French name. In its early years, the firm did not take over French accounting firms, adopting an internal growth strategy. “Local fees,” or local clients, progressively became just as important as “referred fees,” local subsidiaries of foreign firms that had to have the same auditor as the parent
company abroad. Around 1980, the firm expanded its client base to smaller companies and eventually acquired GPA (Peyronnet Gauthier) while maintaining this company strictly separate from its other activities. The objective of this acquisition was primarily to obtain a number of large French clients, but a group of middle-sized clients also came on board [the Andersen story as told by interviewee 7]. Guy Barbier also acquired Frinault in 1987, after the former partners of that firm decided to leave KMG (now KPMG). Other firms adopting similar strategies were Price Waterhouse (merging with BEFEC in 1989) and Deloitte (merging with Calan Ramolino in 1997).

With respect to their establishment outside Paris, different strategies could be observed. Some firms, such as Arthur Andersen, remained focused on Paris for a long time as the presence of Guy Barbier outside of Paris remained limited to Lyon. Most other firms developed from a single Paris office only to an expanded presence throughout the country. Expansion was carried out through associations with local firms as this approach was seen as a more effective, less expensive growth strategy than the creation of new offices.

A totally different strategy is exemplified by KPMG, growing from a local firm into an international one. The origin of KPMG France is Fiduciaire de France, created in Grenoble in 1922. Originally, it was a legal and tax-services firm that extended its activities to accounting only later, mainly due to the development of fiscal regulations. In 1945, the Fiduciaire de France had established its activities all over France and split into two different entities, the Société d’Expertise et de Commissariat aux Comptes Fiduciaire de France and the Fiduciaire Juridique et Fiscale de France. In 1970, it started to look for foreign partners as a consequence of the fact that its clients internationalized. The firm then had auditing standards, a research department and a methodology department, its own professional training organization, and a modern technology orientation. At that time, most of its auditing activities were contractual, not leading to an externally published opinion on financial statements. In 1979, it joined KMG, a federation of the American firm Main, at that time the ninth largest U.S. accounting firm, and the largest national accounting firms in The Netherlands, Germany, the U.K., and France. It was located in Amsterdam. In 1980, it took over Frinault Fiduciaire, a firm that had prestigious French clients. The KMG methodology was subsequently transferred to Frinault Fiduciaire. KMG remained a federation, meaning that there was a common brand, development strategy, and quality control sys-
tem, but also that local identity was respected and profits were not shared on an international level. KPMG was created in 1986, merging KMG and Peat Marwick Mitchell (PMM), known in France as Audit Continental with a staff of about 200 employees. The merged firm adopted the federative model of KMG rather than the centralized PMM model. This resulted in individual economic entities on a national level with a common name and methodology. The brand KPMG Audit was created, employing approximately 450 professionals in Paris. In 1988, KPMG Fiduciaire de France became KPMG S.A. without participating in the capital of the international network but contributing to an international budget. In conclusion, the development of Fiduciaire de France is the outcome of a quite specific strategy. It succeeded in developing from a local firm into an international one, even being part of one of the largest networks in the world. In March 2005, one of the last remaining French firms, Salustro Reydel, decided to join the KPMG network.

The Anglo-American audit firms developed a recruitment strategy that was significantly different from the recruitment policy of traditional French firms. It turned out to be a major innovation that supported the growth of the international firms. French firms mainly recruited staff holding degrees from vocational institutions. From the end of the 1960s onwards, the international firms started hiring high-quality staff generally holding degrees from the Grandes Ecoles management schools. This has to be seen in the wider context following World War II referred to above. The creation of business education along U.S. models was considered essential to structurally embed the U.S, business model. American institutions and organizations encouraged the development of training programs around management-related issues. Schools like HEC and ESSEC in Paris played an important role in the diffusion of new management approaches [Djelic, 1998, p. 211]. Graduates of these schools were strongly attracted to international accounting firms. The teaching staff of the Grandes Ecoles strongly supported MBA and CPA qualifications, which were found in large numbers in the large Anglo-American audit firms. Ambitious graduates were attracted by the high salaries that these firms were willing to offer new recruits. These salaries were systematically higher than those paid by French firms and were complemented with permanent, systematic training and an exposure to business experience that was well beyond mere bookkeeping. This recruitment policy resulted in an inflow of staff capable of obtaining quickly both the French expert-comptable qualification and an expertise in English. The
auditors of Price Waterhouse, who prepared consolidated financial statements for Saint Gobain for the first time in 1976, had to study Anglo-American textbooks because consolidation techniques were not part of the accounting curriculum and very few books on the subject existed in French. Another consequence was that staff members who left the profession quickly became senior executives in industry and frequently called on their former employer for its services. “All those who have left us, have fed the practice,” according to a former Andersen partner. Finally, and even more fundamentally, this recruitment policy also resulted in a rapid “Frenchization” of the big firms. From the end of the 1970s onwards, the partners of the Anglo-American audit firms in France were mainly French citizens born between 1945 and 1950. Almost all the employees of these firms were French, with degrees from the French higher education system, and for the older ones, an expertise comptable degree. Originally, professional bodies, the state, or French society isolated the international firms because of their culture, their nationality, and/or their foreign origins. The growing dominance of French professionals in these firms made it impossible for these market players to continue to marginalize the international firms and made it possible for the international accounting firms to wage a wide-scale commercial battle in the 1980s under very favorable circumstances.

CONCLUSION

The introduction of the large Anglo-American audit firms into the French audit market was a complex process. Today, these international firms dominate the market, and only a few large French firms, such as Mazars, still maintain strong positions. The strategies of the international firms followed a pattern that can be framed within the literature on the internationalization of service industries. Using the entry-mode classification of Anderson and Gatignon [1986], their original entry strategy was a “high-control” strategy, focusing on using expatriate staff involved in auditing subsidiaries of foreign clients of the Anglo-American firms. A specific audit report for the French market was irrelevant in this context. However, this policy significantly limited the growth potential of the Anglo-American audit firms in France. To become larger, they had to expand their activities to French clients as well. In most cases, they chose an external-growth strategy by taking over French audit firms or entering into alliances with local partners. This reduced direct control
over their activities in France, but it was compensated by licensing the use of brand names, common approaches, etc.

Hiring French professionals had two advantages that turned out to be essential to the success of the Anglo-American firms. First, from an institutional perspective, their “Frenchization” can be seen as conforming to the roles and norms of French society, making them more acceptable to the French establishment and making it much more difficult for traditional French accounting bodies to protect the market for audit services. Yiu and Makino [2002] argue that foreign entrants face significant pressure to conform to local standards in this way, in line with Kipping [1999], who underlined the importance of establishing successful external and internal local networks to expand U.S. consulting companies in Western Europe. We go further and state that the “Frenchization” of the international firms was a key success factor for them. Second, the educational background of these French professionals made it possible for the Anglo-American firms to profile their services as being of significantly higher quality than the local standard. Consequently, they became similar to the French service providers, but they could also maintain an image of higher-quality service providers. Agarwal and Ramaswami [1992] considered superiority of assets and skills as a precondition to compete successfully with local service providers. Indeed, the superiority of their assets, their larger size, and their differentiated products both within and around the audit industry made it difficult for the local firms to compete and explains why they became dominant despite their wide institutional distance.

The international audit firms strongly influenced the way audits are carried out in France. Their methodology was transferred to French audit firms by auditors trained in the large international firms but continuing their careers in local firms. This strengthened large local firms, which could start competing with the international firms to gain large clients. These local firms were helped by the French system of co-commissariat joint audit [Piot, 2001]. However, it is doubtful whether these large French firms will continue to play an important role for much longer: The recent integration of Salustro-Reydel, one of the two largest French audit firms, into KPMG illustrates this trend. Increased competition in the market of larger clients also led to recent attempts to increase the market share of the international audit firms in the market of small and medium-sized clients, eventually affecting the whole audit market structure. The traditional audit markets became saturated as both international
and local firms expanded into new types of assurance services and into new markets. This development was interrupted in the post-Enron era when the corporate scandals that shocked the financial markets at the start of the 21st century shifted the focus back to conflicts of interest and auditor independence. On the European level, some basic rules of the game were rewritten in the new Eighth Directive, and France introduced a new supervisory structure and regulation of the financial markets. To a large extent, these changes are taking place now, but their effects will only be seen in the future. It will be interesting to observe how professional structures will reflect these changes and whether they will lead to the renewal of a debate that was essential in shaping the French profession a quarter century ago.

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APPENDIX A

List of the Ten Interviewees

<table>
<thead>
<tr>
<th>Interviewee 1</th>
<th>former member of the Conseil Supérieur de l’Ordre des Experts-Comptables; former president of the Commission des Diligences Normales of the OEC; created a small firm that became one of the largest independent French audit firms</th>
</tr>
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<tbody>
<tr>
<td>Interviewee 2</td>
<td>former president of the Conseil Supérieur de l’Ordre des Experts-Comptables; former partner in a small audit firm</td>
</tr>
<tr>
<td>Interviewee 3</td>
<td>former general secretary of the CNCC; moved from a large Anglo-American firm to create his own small firm</td>
</tr>
<tr>
<td>Interviewee 4</td>
<td>former general secretary of the CNCC</td>
</tr>
<tr>
<td>Interviewee 5</td>
<td>former president of the CNCC; former partner in a mid-sized French firm</td>
</tr>
<tr>
<td>Interviewee 6</td>
<td>former president of the CNCC; former partner in a small French firm</td>
</tr>
<tr>
<td>Interviewee 7</td>
<td>responsible for accounting resources at the COB (AMF)</td>
</tr>
<tr>
<td>Interviewee 8</td>
<td>partner of an Anglo-American audit firm</td>
</tr>
<tr>
<td>Interviewee 9</td>
<td>partner of an Anglo-American audit firm</td>
</tr>
<tr>
<td>Interviewee 10</td>
<td>university professor</td>
</tr>
</tbody>
</table>
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ACCOUNTANTS’ RESPONSIBILITY FOR THE INFORMATION THEY REPORT:
AN HISTORICAL CASE STUDY OF FINANCIAL INFORMATION

Abstract: This paper describes an instructional case that uses historical documentation to enable the reader to consider his/her own responsibility for the preparation and reporting of information. In this case, the reader is provided a summarized income statement. Then, as detailed information about the financial statement is introduced, the reader is asked to consider the ethics of preparing and using the statement. The financial statement represents a projected income statement for a Holocaust camp prisoner during World War II. The statement includes anticipated revenue from the selling of body parts upon the prisoner’s death, estimated as nine months from the time of arrival at the camp. Usage of the case should develop a reader’s understanding that accountants’ responsibility for the preparation of information should not be separate from what the information reports or the intended use of the information.

INTRODUCTION

This paper describes an historical case that poses an ethical dilemma relative to financial statement preparation and reporting. In the case, a summarized income statement is presented. Then, as additional information about the financial statement is introduced, students are asked to consider the ethics of preparing the statement. In actuality, the statement in the case was prepared and used by the German Third Reich during World War II, something students learn only later in the case. The statement is a projected income statement from the Buchenwald concentration camp and includes anticipated revenues from both leasing camp prisoners to for-profit corporations and selling the body parts of these prisoners upon their death, calculat-

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ed to be nine months from the time of their arrival at the camp. The ethical dilemma of this case concerns the responsibilities of accountants and the actions they should take when involved in accumulating and reporting information about immoral or illegal activities.

Accounting is fundamentally a moral practice, not solely a technical determination of reporting standards [Funnell, 1998; Waddock, 2005]. AACSB International has recognized this by requiring an ethics component in the business curriculum for all universities that it accredits [AACSB, 2008]. However, educators do not agree on the objectives of ethics education. Stated objectives include raising awareness of an issue, honing analytical skills, teaching moral reasoning, and/or providing a moral framework for analyzing situations [Falkenberg and Woiceshyn, 2008]. Moreover, Falkenberg and Woiceshyn [2008, p. 213] state that a “consensus has started to emerge that ... the goals should be ... stimulation of the ‘moral imagination’ and identification and application of the students own value sets.”

According to a recent survey of accounting educators, cases are the preferred medium for teaching ethics [Blanthorne et al., 2007]. This is not surprising since the structure of cases often encourages students to apply their own value sets to a particular situation. However, there is a scarcity of cases related to ethics. The Journal for Business Ethics (JBE) acknowledged this problem when in 2008, it established a new section of the journal dedicated to publishing cases concerned with ethical business issues [Falkenberg and Woiceshyn, 2008].

Ethic cases can be classified either as ones concerned with rules (utilitarian and rights theory) or those related to character (virtue ethics) [Mintz, 2006]. Historical cases are particularly useful for virtue ethics since students “need stories of moral courage” to determine how to act correctly [Thomas, 2004 p. 28]. Yet, a bias against historical cases seems to exist. JBE guidance on cases states that the cases should “describe current situations” [Falkenberg and Woiceshyn, 2008, p. 214]. Such bias against historical cases exists elsewhere as well. Weinstein [2005] analyzed cases published between 1985 and 2003 in Issues in Accounting Education (IAE) and the Journal of Accounting Education (JAE), two journals that have published a majority of accounting cases, and posted online his database of case analysis for additional journals. His database [Weinstein, 2008] lists only four cases from his 2005 article that were based on historical data. A review of cases published since 2003 also shows a distinct preference for current cases. Of the approximately 80
cases published between 2004 and 2007 in IAE and JAE (which subsequently merged with Accounting Perspectives), just a single case is based solely on historical data.

Yet, cases developed using current information can present an obsolescence problem. Most cases that were current when published may no longer be relevant just a few years later [Weinstein 2005]. For instance, many cases are concerned with technical knowledge, and recent pronouncements may make older cases obsolete. Additionally, cases based on new situations may be more interesting than older ones with dated topics. However, unlike the cases that Weinstein analyzed, historical cases by their very nature have withstood the passage of time and remain relevant.

Historical instructional cases offer significant opportunities for learning. Use of an historical case allows for ex-post reflection on historical issues present at that time. Such reflections can be applied to current situations that, though different, share some of the underlying themes, providing guidance on how to prevent or improve actions in the present day. In particular, historical ethical cases are important as “humans across time and geography have similar notions of good and bad” [Ramamoorti, 2008, p. 530]. Thus, ethical cases will provide a framework from which students can consider current issues. The use of historical cases also enables students to learn about important events in a multidisciplinary manner. Not only are students exposed to the ethical problems of the case and the accounting questions related to it, they also can appreciate the historical context of the case, sometimes for the first time. For instance, in a recent survey of persons in seven nations, participants’ answers about the Holocaust varied from 54% accuracy in Sweden to 25% accuracy in the U.S. [Smith, 2005]. An accounting ethics case based on the Holocaust will increase student understanding of an historical event that is referenced today but about which students may have little knowledge.1 In addition, since most accounting courses do not cover accounting history in any depth, the use of an historical case can increase student interest in the study of accounting history.2

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1For instance, for greater political effect, activists characterized deaths that occurred in Gaza and Jenin as a “holocaust.”

2Through use of this case, some students have expressed an interest in historical accounting, particularly as related to moral questions. The instructor can direct those students to interesting articles, including Flesher and Flesher [1981], Fleischman et al. [2004], Fleischman and Tyson [2004], and Oldroyd et al. [2008] about valuing slaves; Fleischman and Tyson [2000] about race and accounting in...
While the usage of historical data makes this case unique, its structure is also unusual. The case progresses through various stages, allowing students to consider first the preparation of the statements and then the morality of such preparation, mirroring the process that students will encounter when working. Initially, only a summarized income statement is presented, and students answer questions about the preparation of this statement without knowing its source. In addition, the generic title of the case does not provide information about its true nature. Later, detailed information about the financial statement is introduced, and the material slowly engages students, creating a more pronounced effect about the ethical issues of preparing and using such financial statements.

This case has been used successfully at several universities, in multiple levels of accounting classes and by several instructors. It has been introduced in Accounting Principles, Intermediate Accounting, and graduate-level accounting courses. The case is particularly meaningful when used in classes with students planning a career in accounting since it provides an opportunity for students to consider their responsibility for the statements they produce in addition to learning the mechanics of preparing such statements. While today’s accountants and auditors should not encounter the type of transactions that occurred in the Holocaust, they may observe and potentially generate reports that mask immoral or illegal actions by corporations. Use of this case has allowed students to begin to consider their own responsibilities about the information they report.

In the remainder of this paper, the case is presented. Then, detailed instructor notes are provided.

THE CASE: FINANCIAL STATEMENT ANALYSIS

Instructions: Please read Part I and complete the questions in this section. As a class, we will discuss Part I before beginning Part II. Do not complete the remaining parts until instructed to do so. In this way, we will complete and discuss each part in sequential order.

Part I: The following summarized income statement is from a business that leases its workers to other organizations. This statement is a projection of income earned over a nine-month Hawaiian sugar plantations; and Tyson and Fleischman [2006] about accounting and controls for interned Japanese-Americans during World War II.
period. It includes assumptions regarding the revenue earned and the expenses incurred. The projection was prepared for internal reporting purposes.

Income Statement  
For the nine months ended May 31  
(in thousands)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue from lease agreement</td>
<td>1,620.00</td>
</tr>
<tr>
<td>Expenses:</td>
<td></td>
</tr>
<tr>
<td>Food</td>
<td>162.00</td>
</tr>
<tr>
<td>Depreciation</td>
<td>27.00</td>
</tr>
<tr>
<td>Plus – other income, net of related expenses</td>
<td>200.00</td>
</tr>
<tr>
<td>Net income</td>
<td>1,631.00</td>
</tr>
</tbody>
</table>

Required: Review this income statement for reasonableness of preparation.

1. Recompute net income to determine whether the statement is mathematically accurate.
2. What evidence is there that the income statement is on a cash or accrual basis?
3. Does the income statement appear complete in terms of revenue and expenses? What additional major revenue or expense classifications would you expect for a business of this nature?

Part II: To determine the reasonableness of the projections, review the assumptions made in preparation of the statements. They are as follows:

1. Each worker is assumed to be leased to an organization for a nine-month period.
2. Each worker is assumed to work 12 hours a day.
3. Each worker is assumed to work seven days a week.
4. Each worker is assumed to work 30 days a month.

Required: Critique these assumptions for reasonableness.

Part III: 12.3% of net income comes from “other income.” You discover that this number is a net number of miscellaneous revenue and expenses. To understand better why the amounts were combined, you determine what net revenue represents. You discover that each worker is assumed to work only nine months, as
this is the life expectancy from the time of initial employment. Further, you discover that other revenue represents valuables and currency taken from the employee, gold extracted from the teeth of the deceased, and revenue on sales of personal clothing, hair, fat for soap, and ashes for fertilizer. Other revenue is reduced by cremation costs.

Required:

1. In general, is it appropriate to net together revenues and expenses, or should these be listed separately?
2. Given the nature of the other revenue, what other questions/concerns might you have?

Part IV: This income statement projection represents a statement prepared during World War II at the direction of SS Lieutenant-General Pohl. Concentration camps leased out their prisoners to for-profit corporations, including Krupp, Union Metallendustrie, IG Farbenindustries (IG Farben), Bishmarchkhutte, Oberschlesische Hyderwerke, Siemens-Schuchert, and HermanGoring Werke. Companies used these prison laborers, in addition to their regular employees, to reduce payroll costs and to help alleviate labor shortages [Allen, 2002].

These income projections make several immoral assumptions. These include the work schedule (long workdays, seven days a week), as well as the assumption of a nine-month life expectancy. Because of the harsh working conditions and the small amount of food allotted the employees, the workers are worked literally to death.

Required:

1. What reasons may have existed that encouraged and allowed accountants to prepare these financial statements?
2. Rather than agree to prepare these financial statements, what other actions could the accountants have taken?
3. If you were the accountant asked to draft these financial projections, what responsibility would you have as the preparer of these statements? Specifically, are preparers of statements simply providers of information, removed from the use of information, or does the responsibility of preparers extend further so that they are responsible if the information reports on immoral or illegal activities? You might consider what guidance may exist in the codes of ethics for professional accounting organizations, such as the American Institute of Certified Public Accountants (AICPA) or the Institute of Management Accountants.
Lippman, Accountants’ Responsibility Case

(IMA), or in military codes of ethics, including the Uniform Code of Military Justice (UCMJ) or the American Society of Military Comptrollers (ASMC).

Part V: Additional Optional Considerations: For advanced courses, students can research and complete these optional questions outside of class.

1. How did German companies and executives explain their behavior?
2. Does accounting necessarily place a psychological distance between what occurred and what is reported, thereby sanitizing illegal and immoral acts?

INSTRUCTOR NOTES

The case is designed to be completed in the classroom with students working in small groups. No advanced preparation is necessary prior to working on the case. Initially, students should be provided Part I of the case. Alternatively, we provide students with the entire case but with each part on a separate page. Students are instructed to read each part only when asked. After student groups complete one section of the case, the instructor should engage the entire class in a discussion about that section before students continue to the next one. This sequencing makes the case particularly effective as students progress from believing the case to be a simple income statement analysis to realizing that it entails serious ethical concerns about accountants’ responsibility for the information they report.

Initially, students will approach the case with an attitude typical of group work – cooperative and friendly. However, please note that as students move from Part I to Part IV, the mood of the class will change dramatically. Some students may be visibly upset. Instructors should allow adequate time for Part IV to discuss alternatives accountants have to merely reporting accounting information. In this way, students can develop a sense of ownership over their own behavior when preparing information for others.

The projected income statement used in this case is a translation of a statement from Buchenwald, a German prison camp in operation from 1937 until 1945. This statement estimates net profits from leasing concentration camp victims to for-profit


\[\text{Lippman, Accountants’ Responsibility Case}\]

\[\text{67}\]

\[\text{INSTRUCTOR NOTES}\]

\[\text{The original statement was published under Military Government Information Control License NR-US-W-2010 [Kogon, 1946]. The English translation was published in 1950 [Kogon, 1950].}\]
enterprises and was prepared under the auspices of SS Lieutenant General Pohl, head of the SS Business Administration Main Office, the division responsible for slave labor. In the projections, the workers were estimated to live only nine months since workers were provided little food and shelter while working long hours without rest. Literally, the concentration camp victims were worked to death. Death through labor was a calculated technique that coexisted with death in the gas chambers, and sophisticated accounting techniques helped capture information about these options. Other accounting techniques used by the Germans during the World War II included cost-benefit analysis to determine how to kill children most economically [Lippman and Wilson, 2007] and written reports of expropriated assets of persons killed by the Nazis [Funnell, 1998]. For a more detailed analysis of accounting for slave labor during the Holocaust, see Lippman and Wilson [2007], which provides information about the SS Business Administration Office that developed standardized accounting systems used to account for slave labor.

Part I: The instructor should limit the groups to ten minutes to read and answer the Part I questions:

1. This question is included so that students understand which amounts increase or decrease net income. In particular, students need to realize that “other income, net of related expenses” increases reported net income. The income statement is mathematically accurate.

2. The income statement appears to be prepared on an accrual basis since the statement does include depreciation.

3. Since this represents an organization that earns revenue by leasing individuals to outside organizations, the primary expense should be salary expense. However, salary expense is not included as one of the projections. Students may also suggest that expense disclosures are inadequate since most companies will have other normal operating expenses not listed here. Some students will focus on the lack of earnings per share.

Part II: Students will question the reasonableness of the estimates in the income statement. Students wonder who would willingly work for such a company and whether the law would permit the long hours. Some students hypothesize that this statement is from a third-world country that employs children. Other students attempt to guess the types of industries in the U.S. that require such workloads, including the military during
overseas engagements, residents at hospitals, entertainers, oil-rig workers, persons employed in industries that experience distinct busy seasons, and professors. Some groups want to compute an hourly wage rate; however, insufficient information is provided to do so.

Part III: While there may have been joking among the students with Part II, with some stating that they would never work for such a company, the levy ceases by Part III. Students begin to question seriously the industry, wondering what industry would operate on this basis (mining is sometimes suggested). Some students guess the concentration camps. Other students question why an accountant would continue to work for the company. However, most students will dutifully attempt to answer the question.

Despite the question asked, this section is not really about consideration of proper accounting. Students are provided with some disturbing information about the source of other income. Yet, the question asks students to consider whether the information is presented correctly. By presenting a case where students consider how information is disclosed and not what is disclosed, students are placed in a situation that mirrors the experiences of working accountants. Accountants are concerned with the preparation of financial statements; yet, the underlying information is at least as important, if not more important, than the presentation of that information.

Students are asked to consider presentation, but the appropriateness of such a question, in light of the information, should really be considered first. The instructor can direct discussion to consider whether the information presented is so immoral that questions of presentation appear inappropriate. Hopefully, through discussion, students will discover that blindly answering accounting questions (or preparing information) is not always the appropriate response.

Part IV: To be most effective, Part IV should be withheld from the students until after the discussion in Part III. Then, the instructor can distribute Part IV and read aloud the initial paragraphs of this section to students. It is important to allow sufficient time for this part of the case. In school, students often concentrate on understanding the mechanics of compilation and disclosure of information, not considering whether their responsibility for the information may extend beyond the presentation. Sometimes, this case is the first time students must confront
their moral responsibility for financial information. The instructor can consider theoretical reasons for accountants’ participation while also directing the conversation to the present-day behaviors of accountants when confronted with immoral or illegal situations.

Question 1: Three different types of individuals prepared financial information during the war. Jewish prisoners at the camps were used until they were exterminated or died from the conditions in the camps. Additionally, civilian accountants and SS officers recorded the transactions [Lippman and Wilson, 2007]. Reasons for the participation of the latter two groups in preparation of financial information include:

A. Lack of moral responsibility: Because of the service nature of the profession, accountants’ historical responsibility has been to provide information that is clear and accurate. If accountants’ responsibility ends at the point of information delivery, then accountants would not be responsible for any misconduct that resulted from the utilization of this information, regardless of what the information reports or how the information is used. Thus, some accountants may not feel a moral responsibility about the information they disclose. Research supports the view that accountants are primarily rule-based, following the norms of society, often without the interference of personal values in their work [Armstrong, 1987; Ponemon and Glazer, 1990; Ponemon, 1992]. Some students will be bothered by this characterization, and this case attempts to make students uncomfortable with accountants as financial drones. Yet, often a student in each class does not see the moral problem with accountants as reporters, devoid of a moral conscience about the data they report. This makes for some interesting discussions.

B. Bystander effect: Many persons were involved in or had knowledge of the ill-treatment of the camp victims. Persons are less likely to act when the sense of responsibility is diffused among many persons with knowledge of the transgression [Latane and Darley, 1968]. Thus, the accountants may have assumed that someone else would assist the victims.

C. Normative behavior: In Germany, concentration camps were the norm of that society. In addition, they were legal at that time. Indeed, at the International Military Tribunal following the war, persons used legality as a defense of their actions [International Military Tribunal, 1949]. In discussions, students often state that the U.S. is not the moral equivalent of Nazi Germany, and they believe that normative behavior in the U.S.
would not reach the level exhibited in Germany. However, prior to the rise of Nazism, Germany was among the most enlightened of European countries, and its normative behavior changed dramatically within a short time period once Hitler was elected chancellor in 1933.

D. Inability to visualize a victim: Victims were separated physically from the rest of society, first housed in ghettos and later in concentration camps. Additionally, a psychological separation had been created through legislation. Beginning with the Law for the Restoration of the Professional Civil Service in April 1933 and the Nuremberg Laws of September 1935, regulations were enacted to marginalize the Jews, to both deny them a livelihood and a place in society [Hilberg, 1985]. These decrees had the double effect of dehumanizing the Jews and creating distance between German Jews and other Germans, explaining why there existed a double standard of behavior for Aryan and non-Aryan individuals.

E. Personal safety concerns: Accountants may have been concerned about their own safety had they resisted preparing the statements as requested.

F. Job availability: When jobs are scarce, accountants may have less ability to dictate their job responsibilities.

G. Lack of control: Some accountants may have believed that they could not affect the situation in any measurable way.

Question 2: In this section, students consider alternatives to preparing the statements. As students offer alternatives, the instructor can provide a specific example from Germany when that alternative was used (see below). These examples are evidence that accountants could protest immoral behavior without significant fear of persecution. The instructor can also begin to steer the discussion to the present day.

A. Quit: There were reported instances where accountants quit rather than work with the Nazis [Lippman and Wilson, 2007]. For instance, one accountant protested when the Nazis took over the management of a previously Jewish-owned business for which she worked. She quit her job stating that “she’d rather die” than work for the Nazis [Jones, 1999, p. 219]. Today, quitting a job is an option readily available to accountants.

B. Remain employed but protest within the organization: It is unknown if many accountants protested since little documented evidence of this course of action exists. However, there are reported instances of such resistance by non-accountants. For example, before the use of gas chambers, soldiers would shoot
prisoners in mass killings. Soldiers could, and did, elect not to participate in the shooting without any reprisals taken against them [Browning, 1992]. Additionally, a physician, a non-Jewish prisoner in the Auschwitz concentration camp, was not punished for her refusal to participate in sterilization experiments on her fellow prisoners. In her 1964 testimony at a trial of doctors involved in the program, she stated that doctors, including those already imprisoned, could refuse to participate and avoid punishment. She lamented that few chose this option [Paldiel, 1993]. “Contrary to popular assumption, those who decided to stop or not participate in atrocities were usually given other responsibilities. Quiet non-compliance was widely tolerated” [U.S. Holocaust Memorial Museum, 2009]. Today, corporate responses to persons who, privately or publically, disagree with corporate policy can vary. However, employees do have legal protection if the corporation acts to discredit the accountant.

C. Report immoral behavior to other authorities: In Nazi Germany, most government authorities would not respond officially to requests for help although there are records of individual efforts by persons within the government and the SS [Friedlander and Gerstein, 1969; Paldiel, 1993]. Today, governmental agencies exist that would respond. Additionally, attorneys, environmentalists, or employee unions would willingly offer assistance, and anti-retribution laws protect whistleblowers.

D. Actively work to eliminate problems: Active resistance existed in Germany; however, punishment for such activism was severe. Former accountants involved in the resistance were among those arrested and punished by the Nazis [Jones, 1999]. Today, activists work both within corporations and external to them to affect change.

E. Sabotage efforts through accounting records: In Germany, some individuals used accounting to sabotage the efforts of the Nazis. For instance, a district director of agricultural procurement altered bookkeeping records to increase the number of employees listed as employed at a factory. This allowed the factory to receive extra food, which was used to feed those starving in the ghetto of Zloczow [Paldiel, 1993]. Similarly, a candy factory added a number of Jews to the worker list, thereby saving the lives of these Jews from the gas chambers [Paldiel, 1993]. Altering accounting records today is not a preferred option since sufficient legal means exist.

Question 3: This question is the most important of the case. Students have analyzed an income statement, realized its ori-
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gins, learned of the horrific assumptions used in its preparation, and considered potential alternatives accountants could employ in preparing these statements. This case illustrates the dilemmas accountants may face when executing their job responsibilities. Now, students must ponder their own behavior when working as accountants. By requiring moral reflection, students may begin a critical analysis of their own actions and the effect of these actions on others. To complete this question, students will need access to the code of ethics of various professional organizations to consider whether such codes can provide guidance. The instructor can supply students with the codes or have students research them on the internet.

Professional accounting organizations can assist accountants with moral questions. In Germany during the 1930s, a weak professional accounting organization could offer no assistance to accountants or resistance to the Nazis [Lippman and Wilson, 2007]. However, in the U.S., well-established professional organizations, rich in tradition, can provide professional guidance. For example, the IMA, the International Federation of Accountants (IFA), and the AICPA all have codes of ethics that help define appropriate accountants’ behavior.

Yet, in many respects, present codes of professional organizations are too general to be useful since they rely upon the individual accountant’s interpretation to operationalize ethical behavior. For instance, the codes of the IMA, the AICPA, and the IFA all state that accountants need integrity to determine whether to engage in a particular behavior or to provide certain information. However, specific guidance is weak. Per the IMA [2009, Section III, Parts 2 and 3], accountants are instructed to “refrain from engaging in any conduct that would prejudice carrying out duties ethically ... and abstain from engaging in or supporting any activity that might discredit the profession.” The AICPA [2009, Section 54.03] provides that “integrity is measured in terms of what is right and just.” The standards do not determine what is “right and just,” neither do they provide moral guidance to help accountants determine whether their responsibility extends beyond the preparation of the statements.

Similarly, military codes do not offer specific guidance. The UCMJ is a general code for all military personnel. One section states that all persons must not “bring discredit upon the armed forces” [UCMJ, 2009, Article 134], but whether an accountant who reports illegal acts is bringing discredit to the military is unclear. The ASMC has a “Pledge of Professionalism” that acknowledges its responsibility to the public. While the pledge
discusses integrity, as did the professional accounting organizations, this pledge also acknowledges the added responsibility of public trust and speaks of protecting accountants’ “reputation for good moral character” [ASMC, 2009]. The Defense Finance and Accounting Service [2009], the organization that provides accounting and financial support to the Department of Defense, lists integrity as a main quality that “forms the essential character of each individual within the agency.” Integrity is defined as “doing what is right.” Yet, a specific moral benchmark for what is right or moral is undefined.

Without specific guidance on what constitutes moral behavior for accountants, some students may suggest that legal guidelines can become the minimum criteria. In Germany, the legal bar was low. At the International Military Tribunal Trials held following the war, the court absolved several lower and senior-level accountants from any responsibility for the crimes committed, although the court did convict a top SS accountant. In its findings, the court considered the accountant’s ability to affect change. Those who had knowledge of the killings and who were in a position either to act upon that knowledge or change jobs were convicted of crimes against humanity [Trials of War Criminals, 1950]. Thus, in a world court, the concept of accountants’ accountability was introduced for higher-level accountants, but for most accountants, their liability was non-existent.

While students consider their responses, the instructor might introduce accountants’ responsibilities in more recent cases involving accounting irregularities at U.S. corporations. In many cases, accountants knew of illegal activities and were involved in reporting associated transactions. For instance, at WorldCom, top management asked accountants to make journal entries that improperly capitalized costs. These accountants, senior-level managers who were CPAs, were uncomfortable with the request. One refused to cooperate. One of the others considered resigning. Ultimately, four of these senior-level accountants facilitated the recording of the improper entries [Zekany et al., 2004]. The individuals who actually recorded the journal entries were lower-level accountants who were not prosecuted. However, those in supervisory roles who had the power to affect change were prosecuted and convicted although their sentences were minimal, ranging from five months to one year [New York Times, 2006]. Similar to the German situation, the legal responsibilities of accountants were not significant. Only those in a position to affect change were held responsible, and, even then, punishment was light. Thus, if relying upon the precedent of legal opinions,
accountants’ responsibility remains weak.

Part V – Optional: This case is designed to be completed during a single class session. However, the instructor may wish to extend the case to require additional research and written reflection outside of class. In this way, students can more fully consider the responsibility of corporations that used slave labor and the role of accounting in masking the nature of these transactions. Additionally, these extensions would be particularly appropriate for advanced classes where accounting ethics is an integral part of the curriculum.

Student answers to the optional questions will vary dependent upon each student’s research and analysis. Instructors should evaluate student papers based upon the content and the argument that each student presents.

Question 1: While the SS prepared the financial projection used in this case, established German corporations actively used slave labor and prepared their own statements. This question allows students to consider the lapses in corporate behavior by corporations that used and reported on prisoners who died while working for them. Corporate reasons for their behavior varied. Some corporations resisted aiding Hitler; others were motivated by financial gain; and still others believed in the Nazi ideology [Jeffreys, 2008]. Students may be surprised to find that many companies that aided Hitler, including IBM and Bayer, still exist, and documentation about their immoral legacy is widely available. Several books document German corporations’ use of slave labor and quest for profit [Muhlen, 1959; Wertham, 1978; Ferencz, 1979; Allen, 2002]. Others detail the German cartel IG Farben (which included Bayer) and document the slow disregard of moral values by the company and its executives as they aided Hitler and benefited financially from Nazi policies [DuBois, 1952; Borkin, 1978; Jeffreys, 2008]. IBM’s role in aiding Hitler for financial gain has also been documented [Black, 2001]. Finally, students can read the transcripts from the Nuremberg war trials of the top executives of IG Farben and consider the defendants’ defense that they were unaware of what occurred at the camps and did what all citizens would do to defend their country [United Nations War Crimes Commission, 1949].

Question 2: This question requires research as well as personal reflection by students. They can research accounting’s culpability in immoral acts as reported in the Holocaust [Fun-
nell, 1998; Walker, 2000; Lippman and Wilson, 2007] and slavery literatures [Fleischman and Tyson, 2004; Fleischman et al., 2004], as well as other areas including war literature [Chwastiak, 2008]. When students ponder whether accounting sanitizes immoral acts, they also consider by extension whether accounting is culpable for the immoral acts.

Funnell [1998], Fleischman et al. [2004], Fleischman and Tyson [2004], Lippman and Wilson [2007], and Oldroyd et al. [2008] state that accounting was culpable in sustaining slavery and the Holocaust by normalizing immoral behaviors. Moreover, they argue that accountants were at fault since their reports hid the human dimension of what occurred. Rosenberg and Marcus [1988] called accountants “desk killers” for their participation in reporting immoral transactions of the Holocaust. However, accounting and accountants are not necessarily flawed. Accounting summarizes information, and accountants can prepare statements that accurately report what occurred without sanitizing the nature of the events. When accounting portrays what occurred, accounting and accountants become the catalysts to stop immoral actions rather than contribute to them.

Requiring students to consider whether accounting kills can be transformative yet emotionally difficult for some who complete this case. The financial statement in this case is shocking. Additionally, students are bothered by the lack of accountability of accountants. The reflection required in this case begins the students’ process of determining what value set they want to bring to accounting.

The instructor may wish to conclude this case with an example of positive accounting behavior during the Holocaust. In one evening, the citizens of Denmark successfully ferried all the Jews of Copenhagen out of the country to safety. Two days later, when the Germans came to arrest the Jews, using the well-documented lists of the Jews in the country, all but 477 of the 7,200 Jews had safely departed [Paldiel, 1993]. Individuals had prepared the list of Jews in the country, and then they had actively opposed that which they reported. “The rescue of Denmark’s Jewry was the only instance, throughout all of occupied Europe, of a Nazi liquidation operation meeting with failure” [Paldiel, 1993, p. 370]. Individual moral behavior, collectively applied by a society, made a difference. Individual actions affected change then and, hopefully, they can now. When more accountants are held liable for the illegal or immoral information they report, an elevation of responsibilities could increase the moral behavior of society as a whole.
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Lippman, *Accountants’ Responsibility Case*


ANNOUNCEMENT OF CONFERENCE

Guest Speaker - Prof. Greg Waymire (Emory University, USA)

21st Annual Conference on
ACCOUNTING, BUSINESS & FINANCIAL HISTORY
at Cardiff University, 14-15 September 2009

The conference provides delegates with the opportunity of presenting and discussing theoretical, empirical and review papers (ranging from early working drafts to fully developed manuscripts) in all areas of accounting, business and financial history, in an informal setting. The format of the conference allows approximately 40 minutes for presentation and discussion in order to help achieve worthwhile feedback from those attending. In the past, many papers presented at Cardiff have subsequently appeared in print in Accounting, Business and Financial History, or in another of the full range of international, refereed academic accounting, business and economic history journals.

The 2009 conference, organised by Malcolm Anderson, will be held in the Glamorgan Building, Cardiff University, King Edward VII Avenue, Cardiff, CF10 3WA, UK. It will commence at lunchtime on Monday, 14 September 2009 and conclude in the late afternoon of Tuesday, 15 September 2009.

The conference fee is £125 (this includes all conference materials and the following meals: Monday: lunch, afternoon tea, wine reception and the conference dinner; Tuesday: morning coffee, lunch and afternoon tea). All delegates will need to make their own accommodation arrangements (a list of nearby hotel options can be found on the conference website - www.cf.ac.uk/carbs/conferences/abfhc09/index.html).

Full details can be obtained from Julie Mein, Cardiff Business School, Colum Drive, Cardiff, Wales, United Kingdom. CF10 3EU. Tel +44 (0)29 2087 5731 Fax +44 (0)29 2087 5129 Email. Carbs-Conference@cf.ac.uk

Part of the costs of this conference are being paid by the Institute of Chartered Accountants in England & Wales’ charitable trusts. These trusts support educational projects relating to accountancy and economics. The Centre for Business Performance of the ICAEW manages all grant applications. The financial support of the ICAEW’s charitable trusts is gratefully acknowledged.
Hossein Nouri
THE COLLEGE OF NEW JERSEY
and
Danielle Lombardi
RUTGERS UNIVERSITY, NEWARK

AUDITORS’ INDEPENDENCE: AN ANALYSIS OF MONTGOMERY’S AUDITING TEXTBOOKS IN THE 20TH CENTURY

Abstract: This paper presents the progress of auditor independence from a textbook perspective during the 20th century and into the present. It analyzes the multiple editions of Auditing Theory and Practice by Robert Montgomery. The lengthy time span of these editions is divided into several shorter periods based on major changes and developments in auditor independence. Finally, the paper uses several criteria related to auditor independence to review how the Montgomery text covered these changes and developments.

INTRODUCTION

A review of the literature shows that auditor independence is considered an abstract concept and a state of mind. It is defined as an auditor’s unbiased viewpoint when preparing and issuing an audit report. It is synonymous with honesty, integrity, objectivity, courage, and character. Auditor independence is also viewed as “freedom from the control of those whose records are being reviewed” [Younkins, 1996, p. 322]. It means, in simplest terms, that auditors tell the truth as they see it and are not influenced by other factors, financial or otherwise, while rendering an unbiased opinion.

This paper focuses on the evolution of auditor independ-
ence from a textbook perspective. Auditing textbooks have been important in teaching independence, ethics, and professional values, among other topics, to accounting students before they join the workforce. The emphasis on independence in the textbook has changed over the course of the 20th century as authoritative professional pronouncements have provided new definitions and rules.

Robert Hiester Montgomery’s auditing textbook was chosen for analysis because it is the oldest auditing textbook in the U.S. Montgomery’s career in accounting began in 1889 when he worked as an office clerk for a public accounting firm where he was taught accounting and auditing. In 1898, Montgomery was a founding partner in Lybrand, Ross Bros & Montgomery (LRB&M), later Coopers & Lybrand and currently PricewaterhouseCoopers (PwC). Early in his career, he was associated with several accounting organizations – president of the New York State Society of CPAs in 1922, president of the American Association of Public Accountants (AAPA) from 1912 to 1914, and president of the American Institute of Accountants (AIA) from 1935 to 1937. Although Montgomery passed away in 1953, his textbook continued to be published throughout the remainder of the 20th century by his colleagues at LRB&M, C&L, and/or PwC. Montgomery’s auditing textbook is particularly relevant since many of its recent authors were practitioners, audit partners at Montgomery’s firm and its successors, who also served as accounting standard-setters.

The first edition of Montgomery’s *Auditing Theory and Practice* was published in 1912, with later editions continually updated and published throughout the 20th century. Montgomery had previously published *Auditing: A Practical Manual for Auditors*. Since this book was used in higher education from 1905-1912, the paper starts with this book and then continues with *Auditing Theory and Practice*.

L.R. Dicksee, a native of London and professor of accounting at the University of Birmingham, began his connection with accounting literature in 1891. From that time forward, he became a valued author of many accounting books and journal articles. The 1905 edition of Montgomery’s text contains an authorization from Dicksee explaining that the text encompassed his work with modifications making it applicable to American

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students and professionals. Included in the preface, Montgomery admits that most of the text is taken word for word from Dicksee’s English version, with changes made to reflect “…numerous differences existing between accountancy nomenclature, laws and customs of Great Britain and the United States” [Dicksee and Montgomery, 1905, p. 7]. Montgomery chose Dicksee’s work as his starting point because Dicksee’s British publications had been followed in both the U.S. and the U.K. as standard works on auditing. From this first version, Montgomery began publishing his own texts focusing solely on the U.S.


Criteria against which auditor independence is evaluated are given in Table 1 and are referenced by number in tracing developments in Montgomery’s textbook. These criteria can affect auditor independence, according to the Rules of Professional Conduct (RPC) and SEC rulings. Current rules and rulings are used in Table 1 because they are the most comprehensive developed over time. In addition, they could serve as a benchmark to date milestones in the evolution of independence.

Independence criteria are classified into seven categories in Table 1: 1) state of mind; 2) indebtedness to client; 3) ownership, employment, and other interests; 4) disputes with clients; 5) partner and staff rotation; 6) consulting and management advisory services; and 7) audit fees. The last criterion suggests that since auditors are paid by management, they may accept client positions to obtain the audit job in the future. This is a controversial issue which AICPA and SEC rules do not consider an impairment of independence. However, a 2003 ruling by the SEC requires the audit committee to set the audit fee to minimize the dependence of the auditor on the company.

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2Terms “expansion” and “controversy” periods are adopted from Previts and Merino [1998] with minor changes in the dating of periods.

3These rules were promulgated by authoritative professional bodies, the American Institute of Accountants (AIA) and the American Institute of Certified Public Accountants (AICPA).
TABLE 1

CRITERIA AFFECTING AUDITORS’ INDEPENDENCE

<table>
<thead>
<tr>
<th>1. State of Mind:</th>
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<tbody>
<tr>
<td>• Integrity</td>
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<tr>
<td>• Objectivity</td>
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<tr>
<td>• Character</td>
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<td>• Honesty</td>
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<tr>
<td>• Courage</td>
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<tr>
<th>2. Indebtedness to Clients:</th>
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<tbody>
<tr>
<td>• Transaction with clients (e.g., loans received from clients by auditors)</td>
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<tr>
<td>• Gifts received from clients</td>
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<tr>
<td>• Lunch with clients</td>
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<tr>
<td>• Commission received from clients</td>
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<table>
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<tr>
<th>3. Ownership, Employment, and Other Interests:</th>
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<tbody>
<tr>
<td>• Direct and indirect ownership interest in clients</td>
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<tr>
<td>• Employment relationships (both directly or indirectly through family members)</td>
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<tr>
<td>• Contingent fees</td>
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<tr>
<th>4. Disputes with Clients:</th>
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<tbody>
<tr>
<td>• Litigation between auditors and clients</td>
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<tr>
<td>• Unpaid fees</td>
</tr>
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| 5. Partner and Staff Rotation          |

<table>
<thead>
<tr>
<th>6. Consulting and Management Advisory Services:</th>
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</thead>
<tbody>
<tr>
<td>• Accounting services</td>
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<tr>
<td>• Tax services</td>
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<tr>
<td>• Management advisory services</td>
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<tr>
<td>• Other consulting services</td>
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</tbody>
</table>

| 7. Audit Fees                             |

Source: The AICPA RPC and SEC Rulings

THE EARLY YEARS (PRE-1929)

During this period, Montgomery published five books: Auditing: A Practical Manual for Auditors in 1905, and the first four editions of Auditing Theory and Practice in 1912, 1915, 1921, and 1927. Each book is reviewed with regard to the seven independence criteria. The chief objectives of an audit during this period were to certify the financial condition and operations of an enterprise for its proprietors, executives, bankers, or investors, as well as detection of fraud or errors, with due consideration given [Montgomery, 1912]. These objectives remained constant throughout this period.

1905: The first auditor independence criterion, state of mind, was emphasized in this book. Montgomery noted that desir-
able qualifications of auditors included “tact, caution, firmness, fairness, good temper, courage, integrity, discretion, industry, judgment, patience, clear-headedness, and reliability” (p. 260). In explaining desirable qualifications for an “audit clerk,” Montgomery identified conscientiousness and reliability as important qualifications (p. 261). Montgomery (p. 261) further referred to the second auditor criterion when he noted: “The clerk would be wise … not to get too friendly with his client’s staff. Let him be cautious of accepting favors, and most cautious of accepting presents – which might easily drift into bribes.” To ensure that this did not occur, Montgomery suggested “occasionally changing the rounds of the audit clerks,” a suggestion related to the fifth auditor independence criterion.

Interestingly, Montgomery indirectly touched upon the last criterion of auditor independence, audit fee, in his book. He observed (p. 265):

It is not unnatural that a president, or treasurer, who has, of his own volition, departed from the past policy of his company and called in a professional auditor, should feel some resentment if his own acts when under review do not meet with the approval of the auditor. This resentment is even more marked when the auditor has received the appointment largely as a matter of friendship (which is also of frequent occurrence).

To avoid this problem, he suggested that the stockholders should appoint auditors.

**1912, First Edition:** Montgomery (pp. 30-31) classified the first indirect showing of independence under “auditors’ qualifications” as absolute integrity, courage, and trustworthiness. More specifically, a professional auditor must have impeccable morals and a reputation for absolute integrity, along with the courage to proclaim the truth fearlessly. Montgomery contended that the auditor must be neutral about the interests of the business owners they are auditing as per criterion one. “The auditor must maintain the strictest neutrality, ... and the auditor who has shown any signs of favoritism may find himself in an unpleasant position” (p. 40).

The second criterion was implied in Montgomery’s description of an audit clerk’s attitude. He will reflect “friendly interest,”

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4 The use of the term “audit clerk” by Montgomery implies professional auditors at any level working for public accounting firms.
meaning that the relations between an audit clerk and a client are close and confidential, but not “so friendly” that suspicion may arise questioning the clerk's skill or eagerness to criticize or report on errors (p. 31).

The third criterion is touched upon when Montgomery averred: “A staff auditor cannot very well occupy two positions at the same time; he cannot originate or carry out a transaction which is administrative and later attempt independently to check the same operations” (p. 38). The above quote implies an employment relationship. Montgomery noted that having one individual to carry out administrative duties and later have the responsibility to check the same operations would be more likely to lead to fraud or go unnoticed.

As in 1905, Montgomery indirectly referred to audit fee, the last criterion. He stated (p. 48):

Auditors are sometimes placed in an embarrassing position through their appointment by the very officer whose accounts they are supposed to audit and criticize. This is peculiarly a situation which requires tact. In view, however, of the clear duty of an auditor to be helpful, it need not be assumed that the work cannot be done as well as in the case of a more independent appointment.

In this edition, Montgomery also reproduced Article VI of the by-laws of the AAPA, submitted at its September 1912 annual meeting. The second Rule of Conduct expressively relates to the second and third criteria (p. 57):

No member shall directly or indirectly allow or agree to allow a commission, brokerage, or other participation by the laity in the fees or profits of his professional work, ... nor perform accountancy work payment for which is contingent upon the result of litigated or arbitrated issues.

The third Rule of Conduct of the by-laws read, “no member shall engage in any business or occupation conjointly with that of a public accountant, which in the opinion of the Board of Trustees is incompatible or inconsistent therewith.” This also addressed the third independence criterion.

In summary, the first edition placed a significant emphasis on integrity and rules of professional conduct [Hatfield, 1913]. In addition, several pages of the book were allocated to legislation pending in Pennsylvania and New York relating to the appointment of the auditor and the auditor's remuneration.
However, there is no direct discussion of independence and confidentiality. According to Previts and Merino [1998, p. 204]:

Many believed to do so would mean inevitable dilution of intent. Accountants sought, rather, through the national organization and within the practitioners’ offices, to internalize those values so that they were completely accepted and respected by everyone who entered the profession of public accounting. They believed that intellectual independence and confidentiality were absolutes that must apply in all circumstances.

1915, Second Edition: In contrast to the foregoing, this edition did not include most of the independence criteria. Even the first criterion was not sufficiently emphasized in this edition. The only other criterion discussed was contingent fees. Montgomery acknowledged in the preface that chapters on ethics had been deleted to allow space for new materials. Omitting the chapter on ethics in this edition was, therefore, a disservice to students and the practice of accounting. While the next two editions of the textbook started to include some rules of professional conduct, it was not until the 1934 edition that Montgomery again included more discussion of independence and ethical values.

1921, Third Edition: In the preface of the third edition, Montgomery noted that during the years since the second, he had received many criticisms and suggestions from students and other readers of the textbook. Since a new section on professional ethics was now again included, it is reasonable to assume that one criticism was the elimination of the ethics chapter. This shows that the concept of professional values, ethics, and independence was of great importance early in the 20th century and has continued to the present.

As Montgomery wrote in the preface of this edition, the book claimed to be comparable to a general audit program. Therefore, it was similar to the previous edition with regard to covering independence criteria with a slight variation. It added a section on professional ethics which included the eleven Rules of the AIA. Rule four, which related to the second criterion, proclaimed (p. 13):

No member shall directly or indirectly allow or agree to allow a commission, brokerage or other participation by the laity in the fees or profits of his professional work; nor shall he accept directly or indirectly from the laity any commission, brokerage or other participation
for professional or commercial business turned over to others as an incident of his services to clients.

The eleventh and final rule related to criterion three. This rule provided that: “No member shall render professional service, the anticipated fee for which shall be contingent upon his findings and results thereof” (p. 14). Other than this minimal change, this edition was similar to the second.

1927, Fourth Edition: Like the third edition, there was not much change in the 1927 text. The rules of the AIA on professional ethics were reproduced as in the previous edition. The only differentiation was that this edition added another section featuring a discussion of professional ethics in which Montgomery asked for “an even wider conception of moral responsibility” (p. 19) rather than mere adherence to the rules of professional ethics.

Summary: During the early years, the audit profession started to mature. This period witnessed an importance placed on integrity and objectivity with little emphasis on independence. In discussing independence and confidentiality notions, Previts and Merino [1998, p. 204] noted:

It was assumed that any person permitted into the ranks of accountancy had been conditioned to accept both notions as fundamental norms during this period of practice experience. If that were not the case, then the practitioner-mentor had an ethical and moral responsibility to see that the person who did not measure up was barred from admission into the profession. Practitioners rejected the idea that by promulgating rules – especially rules that by their nature could have dealt only with peripheral matters – either confidentiality or appropriate independence could be assured.

While the textbooks during the first half of this period included an extensive discussion of the rules of professional conduct and seemed to emphasize the concepts of integrity and objectivity of professionals, the second-half editions either completely ignored the ethical values or minimally covered the eleven written RPC promulgated by the AIA, primarily those dealing with other responsibilities and practices of auditors.

Montgomery [1912] suggested that audit firms obtain bonds on the audit clerk to assure independence and proper audit. He stated that by requiring bonds, “the employer is assured that a
most exhaustive inquiry is made into each applicant’s character and reputation, extending back over a considerable period of years” (p. 39). This was an innovative idea, but since auditing firms did not seriously pursue it, this idea was dropped from later editions.

Montgomery [1912, p. 48] recommended that auditors must report what he called “severe criticism” and avoid reporting “unimportant matters.” He further suggested that reporting severe acts and omissions of the officers could result in “a dislike of all professional auditors and a failure to give consideration to the report.” This is because, according to Montgomery, the officer was much closer to the board of directors than the auditor. Therefore, if anything short of fraud was reported, the auditor would lose prestige and perceived value, which in the long run might also hurt the whole profession. These arguments seemed to contradict the whole idea of independence. During this period, the auditor and firm only needed to certify that the financial statements were correct. The other reason may be that a very small number of corporations were audited and there was a tendency to increase audits, even without a lack of independence. For example, Montgomery [1912, pp. 48-49] noted that: “Some slight advance has been made towards popularizing a provision in the corporation by-laws requiring the accounts to be audited by professional accountants, but such a provision has, so far, not been adopted by even one per cent of the corporations of the United States.”

In summary, there was no formal definition or rule on auditor independence during this period, just random pieces implying that independence should be used. In terms of the independence criteria, the main focus was on state of mind with some sporadic and indirect discussion of indebtedness to clients, ownership, employment and other interests, partner and staff rotation, and audit fees.

STOCK MARKET CRASH PERIOD (1929–1945)

Although the stock market crash occurred in 1929, ramifications from it did not appear in Montgomery’s textbooks until the 1940 edition. It can be argued that independence was not considered an issue during the decade of 1930s because auditors were never considered contributors to the 1929 crash. The main causal factors were stock speculation, margin buying, and stock manipulation. In addition, according to Seligman [1982], hearings of the Senate Banking Committee and other congressional
hearings identified a number of other causes: high salaries and interest-free loans for corporate executives, various tax-avoidance schemes, payments to publicists intended to inflate stock prices, family members of corporate insiders who profited from trading in their own company’s stock, various other efforts to manipulate the market and specific stock prices, and an investment banking system that allowed politicians and corporate executives to make quick profits by buying stocks at low prices and selling them after the companies went public. Since auditors were not considered a major contributor to the 1929 crash, Montgomery may not have felt it was necessary to include the independence issue in the 1934 edition. During this period, there were only two new editions of Montgomery’s text, those of 1934 and 1940.

1934, Fifth Edition: In this edition, the word “independence” first appeared in Montgomery’s textbook. For example, in discussing the banks’ need for auditor reports, Montgomery stated that “the auditor, by reason of his experience and independence, is able to assist the banker in forming his judgment” (p. 20). He also observed, “all partnership books should be adjusted by a professional accountant, if for no reason than that he will act impartially” (p. 21). It should be noted that the concept of independence had just begun to appear in practice. Therefore, the way it was treated (i.e., adjusting books by an independent professional accountant) could have been different from what is considered independence today.

Several passages indirectly referred to the independence criteria. Montgomery linked the audit fee to independence when he suggested that the auditor's report should be “made to the stockholders, not to the officers and directors” (p. 22). He referenced the RPC in which rules four and ten were linked to the second and third criteria respectively. In addition, rule 12, incorporated into the RPC and reflected by the third criterion, stated (p. 14):

No member or associate of the Institute shall be an officer, director, stockholder, representative, agent, teacher or lecturer, nor participate in any other way in the activities or profits of any university, college or school which conducts its operations, solicits prospective students or advertises its courses by methods which in the opinion of the committee on professional ethics are discreditable to the profession.

Similar to the fourth edition, the fifth added another section on professional ethics in which Montgomery “urges an even
wider conception of moral responsibility” (p. 14) than simple adherence to the RPC. He again emphasized “honesty” and noted, if one “is not absolutely honest, he is never free from bias and is unable to separate truth from falsity; it may even be said he cannot distinguish the essential from the nonessential” (p. 10).

1940, Sixth Edition: In this edition, there were major changes on the auditor independence issue. The 1929 crash was a major explanatory factor in the changes. The word “independence” was first used and defined here, and implementation rules on auditor independence were contained in the Securities Acts. Thus, the crash not only spawned the Great Depression but also revealed unacceptable accounting practices at public companies that had gone bankrupt.

Montgomery defined independence as follows: “Independence, in the sense used above, is the opposite of subservience; it implies an attitude of mind completely objective, without bias, and free from the influence of any affiliation which affect judgment or any matter” (p. 18). While Montgomery noted that it is difficult to determine what circumstances might affect auditor independence, he referred to direct employment, “ties of friendship or kinship between the auditor and personnel of his client” and direct ownership interest in clients as factors that reduced auditor independence (p. 18).

Montgomery noted that a demand for independent public accountants to examine published financial statements had grown quickly over the past few years. It was perceived as an advantage for stockholders when the company had an independent audit. In addition, certain rules and regulations had been implemented based upon having an independent public accountant. First, if a corporation’s securities were listed on the national securities exchanges, it should file financial statements with an accompanying report from an independent public accountant. This should be a component of the initial registration statement, as well as part of succeeding annual reports required to be filed with the SEC. Second, it was required by the New York Stock Exchange (NYSE) that for listing after July 1, 1933, except for railroads, independent public accountants must audit the annual reports of listed companies. Third, as part of the Security Act of 1933, investment bankers considered it crucial that financial statements be accompanied by independent public accountants’ reports as part of the initial public offering of securities. Fourth, there was a provision for indentures implemented with bonds that stated that trustees should be provided annually financial
statements and a report from an independent public accountant. Finally, grantors usually required reports by independent public accountants prior to extending credit.

“The independence of public accountants is crucial to the credibility of financial reporting and, in turn, the capital formation process” [Walker, 2002b, p. 11]. The new requirements for independent audits did not shift the SEC’s and the NYSE’s focus away from reliability, but rather expanded it because reports issued by an independent auditor were viewed as reliable by the public. Auditor independence is crucial because two important qualitative characteristics, relevance and reliability, are captured by the auditor’s assurance on financial statements.

On May 6, 1937, the SEC recognized the significance of a professional accountant’s total independence when reporting on financial statements. An independent audit provides the public the confidence needed in relying on financial statements, which then promotes investments in the securities of public companies. Montgomery (p. 18), in keeping with criterion three, wrote of Accounting Series Release #2:

...the Commission has taken the position that an accountant cannot be deemed to be independent if he is, or has been during the period under review, an officer or director of the registrant or if he holds an interest in the registrant that is significant with respect to its total capital or his own personal fortune.

Summary: During this era, there was formal mention of auditor independence. It was in the 1940 edition where Montgomery fully explained independence and its implementation. Given the 1929 crash, he realized that something had to be done. However, the actual change did not appear in his textbook until 1940 when he wrote:

The importance of independence is emphasized when there may be apparent conflict of interest between management and stockholders, or between classes of security holders; the auditor must be independent to insure his arriving at an unbiased opinion in the face of conflicting interest (p. 18).

The Securities Acts made some impact on auditor independence, but as Previts and Merino [1998, p. 273] noted, they were “designed to restore public confidence in the economic system,” and represented little more than symbolic regulation. The rules of auditor independence were considered adequate during this
period,\(^5\) as evidenced by the statement of James Landis [1936, p. 4], chairman of the SEC, that “the impact of almost daily tilts with accountants, some of them called leaders of their profession, often leaves little doubt that their loyalties to management are stronger than their sense of responsibility to the investor.” Likewise, the comment of Robert Healy [1938, p. 5], commissioner of the SEC, categorized auditors as “special pleaders for their more lucrative clients.”

In summary, while “independence” started to appear during this period in the textbook, there were still few rules or directions with regard to auditor independence. From the independence criteria, the main focus was still on the state of mind criterion with some discussion of criteria two and three and indirect references to criterion seven.

**EXPANSION PERIOD (1946-1959)**

After World War II, the American economy started to grow at a rapid rate. The expansion of American businesses led to the need for new auditing standards. In October 1947, the CAP issued a statement on auditing standards. General Standard #2 prominently dealt with independence: “In all matters relating to the assignment, an independence in mental attitude is to be maintained by the auditor or auditors” (p. 12). Under the section “Independence of Public Accountants,” independence was considered a “reflection of honesty and integrity” (p. 22).

*1949, Seventh Edition:* This edition of Montgomery’s textbook is coauthored by Lenhart and Jennings, both CPAs and working practitioners at LRB&M. Throughout this edition, “the professional attribute of independence” was articulated with emphasis given to the Statements on Auditing Standard by the CAP and the RPC. Montgomery reprinted the Statements on Auditing Standard, which included general standards, standards of field work, and standards of reporting. Specifically, General Standard #2, “in all matters relating to the assignment an independence in mental attitude is to be maintained by the auditor or auditors” (p. 12), directly relates to the first criterion of independence.

\(^{5}\) The reason that independence was not considered adequate until the 1940 edition could be due to the fact that no authority existed to establish accounting standards in the 1930s. In fact, it was not until 1938 that the SEC delegated its authority to set accounting standards to the AIA and the Committee on Accounting Procedures (CAP). In addition, Montgomery himself was not a fan of independence [Previts and Merino, 1998].
Similar to the previous edition, Montgomery discussed the value of independence for different services offered by public accountants. He contended that “even in services in which independence is not expected, the public accountant should maintain his objectivity, honesty, and integrity” (p. 8). The main focus of independence still rested on a “reflection of honesty and integrity” (p. 22). Although Montgomery referred to this as a RPC, those rules of conduct were not specifically reproduced in this edition. Instead, he referred the reader to Professional Ethics of Public Accounting, published in 1946 by John L. Carey, executive director of the AIA.

This edition, as well as the later 1957 one, presented Rule 2-01 of the SEC with regard to the “Qualification of Accountants.” Part (b) of this rule explained how the Commission would only recognize an accountant as independent if he was, in fact, independent. For example, if an accountant had any direct or indirect financial interest in a client for whom he was working, he could not be considered independent. Part (c) of the rule specified how to determine if an accountant was in fact independent. In brief, it stated, the Commission must have given proper thought to all relevant circumstances to all relationships between the accountant and the client to determine independence. In addition, the Commission had the authority to disqualify or deny an accountant the ability to appear or practice before it, if the person was found “not to possess the requisite qualification to represent others; or to be lacking in character or integrity or to have engaged in unethical or improper professional conduct” (p. 503). This was stated under Rule II (e) of the Commission's Rules of Practice.

1957, Eighth Edition: Since Montgomery passed away in 1953, this edition of Montgomery’s book was authored by Norman Lenhart, LRB&M chairman, and Philip Defliese, a prominent LRB&M partner. In an effort to describe the independence of public accountants, the 1957 textbook discussed those accountant’s qualities related to independence. For instance, the authors opined that “independence is an inward quality, not susceptible of objective determination or definition” (p. 24). An accountant’s principal asset was his independence and integrity. The authors mention that public accountants needed independence in attitude to be truly independent.

In this edition, the RPC, as revised in December 1950, were once again published. The authors stated that “these rules are of such importance in reinforcing requirements of general
standards for adequate training and efficiency, independence, and due care that they are reproduced” (p. 21). Rules related to independence were [pp. 22-23]:

(3) Commissions, brokerage, or other participation in the fees or profits of professional work shall not be allowed directly or indirectly to the laity by a member.
Commissions, brokerage, or other participation in the fees, charges, or profits of work recommended or turned over to the laity as incident to services for clients shall not be accepted directly or indirectly by a member.

(9) Professional service shall not be rendered or offered for a fee which shall be contingent upon the findings or results of such service. 

(11) A member shall not be an officer, director, stockholder, representative, or agent of any corporation engaged in the practice of public accounting in any state or territory of the United States or the District of Columbia.

(13) A member shall not express his opinion on financial statements of any enterprise financed in whole or in part by public distribution of securities, if he owns or is committed to acquire a financial interest in the enterprise which is substantial either in relation to its capital or to his own personal fortune, or if a member of his immediate family owns or is committed to acquire a substantial interest in the enterprise. 

While rule three reiterates the second criterion, rules nine, eleven, and thirteen relate to the third criterion.

This edition also emphasized the first criterion by stating that “independence is a reflection of honesty and integrity.” In addition, rule five of the RPC had “special importance” because it described acts that were considered “discreditable to the profession” (p. 24):

It supports the public accountant in his insistence upon an independent attitude, emphasizes the necessity for application of generally accepted accounting principles and for making his examination in accordance with generally accepted auditing procedures applicable in the circumstances, and is of great importance in determining the public accountant’s responsibilities for his opinion on financial statements.
Summary: For the first time during this period, there were official guidelines to follow that related to auditor independence. The statement on auditing standards, which discussed independence under its general standards, appeared in the 1949 edition and in all future editions. Independence was becoming an official component of generally accepted auditing standards to be followed by all public accountants. Still, independence in fact was considered important but with no attention paid to independence in appearance. In addition, “despite the rapid growth in scope of services to include tax and management services, which created serious questions about [the] independence of audit firms” [Previts and Merino, 1998, pp. 338-339], there was no discussion of the effect of consulting and management accounting services (criterion six) on auditor independence in Montgomery’s auditing books during this period.

CONTROVERSY PERIOD (1960-1975)

This period was marked by controversy over accounting methods (e.g., historical cost versus replacement cost), corporate social responsibility (e.g., social accounting and social audits), and whether “relevance” should have been the primary determinant of an asset’s existence. In addition, due to expanded services by audit firms, the AICPA adopted new rules of conduct in 1973, which required independence both “in fact” and “in appearance” for audit opinions on financial statement fairness. In 1975, the ninth edition of Montgomery’s textbook was published, 18 years after the last edition.

1975, Ninth Edition: This edition was authored by three CPA practitioners (Defliese, Johnson, and Macleod; all partners at C&L) who discussed independence in great detail as part of general auditing standards. After defining independence based on the Statement of Auditing Standards, the textbook used authoritative pronouncements to elaborate the independence issue. In particular, the Code of Professional Ethics and Regulation S-X are quoted ([pp. 18-19]).

The Code of Professional Ethics introduced Rule 101 “Independence,” providing that, “a member or a firm of which he is a partner or shareholder shall not express an opinion on financial statements of an enterprise unless he and his firm are independent with respect to such enterprise” (p. 18). The rule gave examples of when independence was impaired; however, it reminded the reader to keep in mind that the given examples were not all-inclusive. The examples can be categorized under
the first three independence criteria.

The text maintained that “auditor’s independence and objectivity must be visible and explicit rather than underlying and implicit” (p. 20). Also, Statements of Auditing Standard #1 and #4 explain how one must not only be independent in fact, but also must appear independent. The SEC provided details on relationships that may or may not lack independence. Those details parallel criterion three. Two of the examples provided were (p. 20):

No partner in an auditing firm, nor a member of his immediate family, is permitted to own even one share of stock of a client or affiliated company or even to participate in an investment club that does hold such shares, no matter what his personal fortune, the size of the company, or his distance from the actual work of the audit.

An auditing firm may not have its employees/pension fund managed by an investment counselor that also manages a mutual fund client; there is no actual financial relationship, but there might be an appearance of lack of independence.

The textbook also covered audit fee, observing that “the greatest practical threat to an auditor’s professional, independent mental attitudes is that he is often selected, retained, or replaced at the sole discretion of the management on whose representations he is expected to report” (p. 20). The authors suggested that the selection and retention of auditors by the stockholders should have remedied this independence problem. Another way to reduce this type of independence problem was to report to a committee of “outside directors” of a client company.

Summary: The major change that took place during this period was the emergence in authoritative pronouncements of the independence issue as a concept of both “independence in fact” and “independence in appearance.” According to Previts and Merino [1998, p. 339], “accountants had long recognized the importance of maintaining independence in appearance as well as in fact.” They contended that the 1962 Code of Professional Conduct included a rule to that effect. However, it was not until 1975 that independence in appearance was introduced in the textbook.

IDENTITY CHANGE PERIOD (1976-1990)

This period was characterized by a rapidly expanding practice base and changes in the range and scope of services [Previts...
and Merino, 1998]. During this period, the tenth and eleventh editions were published.

1987, Tenth Edition: This edition was authored by Defliese (retired chairman of C&L and professor at Columbia University), Jaenicke (professor at Drexel University), Sullivan (C&L director of audit policy), and Gnospelius (C&L managing partner). In this edition, the authors dropped the discussion of SEC Independence Rule 2-01 of Regulation S-X, but added many new elements to the textbook.

First, the role of independent audits as described by the Financial Accounting Standards Board in Statement of Financial Accounting Concepts No. 1 was quoted:

…Independent auditors commonly examine or review financial statements and perhaps other information, and both those who provide and those who use that information often view an independent auditor’s opinion as enhancing the reliability or credibility of the information (p. 10).

Second, there was a discussion of control, which was considered an audit function by the American Accounting Association Committee on Basic Auditing Concepts. It was seen as an audit function to maintain control over the quality of information because it acted as an independent check on information. Moreover, if the preparer knew that an independent auditor would be checking his work, he would take greater pains to guarantee its accuracy.

The AICPA Code of Ethics and its four categories – Concepts of Professional Ethics, Rules of Conduct, Interpretations of Rules of Conduct, and Ethics Rulings – were discussed in detail. Also, five ethical principles were included in the Code ET Section 51.07, and independence, integrity, and objectivity were embodied in the Code ET Section 52.01. ET Section 52.02 defined independence as “the ability to act with integrity and objectivity.”

The Statements on Auditing Standard and the Code of Professional Ethics both explained the importance of appearing to be independent, when such was not the case. Subsequently, there was a discussion of Interpretation 101-3 (ET Section 101.04) relating to accounting services (criterion 6), Interpretation 101-4 (ET Section 101.05) relating to family relationships (criterion 3), and Ethics Ruling 52 (ET Sections 191.103-104) relating to past-due fees (criterion 4). For accounting services,
Interpretation 101-3 permitted (pp. 64-65):

Members to provide bookkeeping or data processing services to nonpublic audit clients only if the following requirements are met: ... no relationship or conflict of interests between the CPA and client ..., CPA must not assume the role of an employee or management of the client, ... the CPA must comply with generally accepted auditing standards.

Interpretation 101-4 addressed three categories of family relationships. The first category enjoined a member’s spouse, dependent child, or relative living in his household from having financial interests or business relationships with the particular client(s). Next, close kin, siblings, parents, etc., were not allowed to have “significant financial interest” in the client. Finally, remote kin, uncles, aunts, cousins, etc., were not “ascribed” to the client unless there was “closeness” with the client.

Ethics Ruling 52, concerning the impact on independence of past-due fees, was reviewed. It stated, “Independence may be impaired if more than one year's fees are unpaid when the member issues a report on the client's financial statements for the current year (p. 65).”

The text also mentioned Rule 302 (ET Section 302.01) related to contingent fees (criterion 3) and Rule (503) ET Section 503-01) related to commissions received from clients (criterion 2). Rule 302 provided (p. 70):

Professional services shall not be offered or rendered under an arrangement whereby no fee will be charged unless a specified finding or result is attained, or where the fee is otherwise contingent upon the findings or results of such services. However, a member’s fees may vary depending, for example, on the complexity of the service rendered.

Rule 503 read, “A member shall not pay a commission to obtain a client, nor shall he accept commission for a referral to a client for products or services of others” (p. 73).

Statement on Quality Control Standard #1 described nine elements relating to a firm’s quality control and mandated firms to consider them all. Element eight, independence, urged that “policies and procedures should be established to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the rules of conduct of the AICPA” (p. 76).
Finally, there were three other relevant discussions relating to independence. One was concerning disciplinary actions against individuals for violating the Code of Professional Conduct. Another dealt with proposals to enhance the independence of audits, including “protecting the auditor from management influence” through the audit committee and transfer to the public sector (criterion 7), “rotation of auditors” (criterion 5), and “prohibition of non-audit service” (criterion 6). In summary, this edition provided a comprehensive discussion of independence issues but for some minor items.

1990, Eleventh Edition: The eleventh edition was authored by Defliese, Jaenicke, O’Reilly (C&L deputy chairman of accounting and auditing), and Hirsch (C&L vice-chairman of auditing). This edition included only minor changes from the tenth. It added the six principles of the Code of Professional Conduct: responsibilities, the public interest, integrity, objectivity and independence, due care, and scope and nature of services. This edition dropped the discussion of ET Section 52.01 with regard to independence, integrity, and objectivity, but added definitions for integrity and objectivity (p. 61). Finally, this edition included Rule 102, which stated:

In the performance of any professional service, a member shall maintain objectivity and integrity, shall be free of conflicts of interest, and shall not knowingly misrepresent facts or subordinate his or her judgment to others (p. 64).

In addition, this edition noted that the SEC had certain requirements including the periodic rotation of partners, review of audit reports by another partner, and annual communication by the audit committee. A discussion of audit personnel rotation was also included in this edition, but it was noted that the Cohen Commission had not made it a requirement.

Summary: Independence was becoming imperative and was described in much more detail than prior editions. Public accountants who violated the Code of Professional Conduct could have had disciplinary actions taken against them, including “letter of minor violation,” “administrative reprimand,” or “presentation of a prima facie case to a joint trial board” (p. 80). However, as Previts and Merino [1998, p. 339] noted, “the Code was not as forceful as it could have been” in disciplinary actions against public accountants.
Although the SEC, the AICPA Code of Professional Conduct, generally accepted auditing standards, and individual firms required independence, total independence may have been impossible to attain. There were always potential threats since the client selected and paid the auditor. Auditors themselves were aware of how vital independence was to their reputations, but there was no guarantee that independence would be maintained. Other non-audit services, such as tax and management services, were also threats to auditor independence because neither the SEC nor the AICPA prohibited these services from attest engagements.

MANAGEMENT CONSULTING PERIOD (1991-2000)

In this period, a significant portion of public accounting firms’ revenue was derived from tax and management consulting services, which overshadowed auditing fees. During this period Montgomery’s twelfth edition was published. The biggest change that post-dated the 1998 textbook was the creation of a new regulatory structure in the aftermath of the Enron/Arthur Andersen scandal.

1998, Twelfth Edition: The authorship team for this edition were O’Reilly (a retired C&L vice-chairman), three PwC assurance partners (McDonnell, Winograd, and Gerson), and Professor Jaenicke once again. This edition was mostly consistent with the previous one regarding auditor independence. Major changes on the topic included the Independence Standards Board (pp. 3-12); SEC Independence Rule 2-01 of Regulation S-X, included in the ninth edition but subsequently dropped (pp. 3-13); an expanded discussion of loans received from clients (pp. 3-14); independence and agreed-upon procedure engagements and interpretation 101-11 (pp. 3-15); and auguring the future, a discussion of the prohibition of management advisory services, focusing on the SEC’s Staff Report on Auditor Independence, which concluded that no changes in SEC rules and regulations were needed.

The edition also touched upon extended audit services and interpretation 101-13, stating that: “Extended audit services, such as assisting in the client’s internal audit activities and performing audit services that go beyond the requirement of GAAS, does not impair independence, provided the CPA does not act or appear to act in the capacity of the client’s management or employees” (pp. 3-15).
Finally, the text discussed “Strengthening the Professionalism of the Independent Audit,” a report published by the Advisory Panel on Auditor Independence, which was appointed by the Public Oversight Board (POB).

**Summary:** Only one edition of Montgomery’s auditing textbook appeared during this period. A detailed discussion of independence criteria was presented in this edition, highlighting significant changes that had taken place up to the date of publication.

**LEGALIZATION PERIOD (2001-PRESENT)**

The Enron/Arthur Andersen scandal, as well as other accounting irregularities, spurred Congress to institute the Sarbanes-Oxley Act (SOX) in 2002. The Enron debacle caused a shift of focus as investors, creditors, and other users of financial statements began to lose trust that audit committees and boards of directors were effectively executing their assigned responsibilities. The following sections discuss developments in independence since the last publication of the Montgomery textbook in 1998.

**2001 POB – Final Annual Report:** In 1999, the Independence Standards Board adopted Independence Standard #1 which encouraged discussions with audit committees. However, in July 2001, the Board was terminated because the AICPA and the SEC did not agree with its actions. The POB felt that it was time for Congress to enact reform that would make a difference.

In January 2002, the Commission’s chairman, Harvey Pitt, issued a proposal to institute a new private-sector regulatory structure. However, the POB was excluded from the discussions, leading to its dissolution. The POB felt that a new regulatory structure would be both feasible and essential, and it recommended that Congress create the Independence Institute of Accountancy (IIA) to be the center of all regulations.

The POB suggested the IIA be comprised of a seven-member board to run the Institute independent of the AICPA and all accounting firms. The members should be appointed by a panel composed of the SEC chair, the Federal Reserve Board, and the secretary of the treasury. The funding should also be independent from firms. The important functions of the IIA would include “oversight of all standard setting bodies; yearly and special reviews; investor powers; international liaison; and profes-
sional education and training” [POB, 2001, p. 53].


“For over 70 years, the public accounting profession, through its independent audit function, has played a critical role in enhancing a financial reporting process that has supported the effective functioning of our domestic capital markets, which are widely viewed as the best in the world” [Walker, 2002b, p. 8]. The demise of Enron led to the public questioning “the effectiveness of our systems of corporate governance, independent audits, regulatory oversight, and accounting and financial reporting, which are the underpinnings of our capital markets…” [Walker, 2002a, p. 29]. The public’s loss of confidence in independent auditors and the reliability of financial information made change imperative.

SOX attempted to balance auditor independence with audit quality. Two safeguards taken were “pre-approval by the audit committee of audit and non-audit services; and disclosure to investors of the company’s pre-approval policies and its audit and non-audit service fees” [Ernst & Young, 2003, p. 1]. These two safeguards relate to criteria six and seven.

As for non-audit services, three new restrictions were developed, “a prohibition on financial information systems design and implementation services; a prohibition on internal audit outsourcing services; and a restriction on certain types of ‘expert’ services” [Ernst & Young, 2003, p. 2]. The rules specified a rash of expert services that could no longer be provided “unless it is reasonable to conclude that the results of the service will not be subject to audit procedures during an audit of the client’s financial statements…. Tax services are the only permitted non-audit service that Congress specifically names, in passing the Act, as being subject to the audit committee pre-approval requirements and not included in the prohibited service restrictions” [Ernst & Young, 2003, p. 5]. However, recent rules of the Public Company Accounting Oversight Board (PCAOB) restrict the tax services that independent auditors can provide. According to the PCAOB new rules, independence is violated if an audit firm provides any non-audit service to a client relating to advertising, developing, or opinion rendering in favor of tax transactions that are performed under a confidentiality condition or are belligerent. Tax transactions are aggressive if
they meet at least one of these three criteria: (1) they are initially recommended by the audit firm, either directly or indirectly; (2) a significant purpose to the transaction is tax avoidance; or (3) the tax treatment is more likely to be disallowable under applicable federal, state, local, or foreign tax laws.

SOX provided that all non-audit and audit services should be pre-approved by the audit committee if performed by an independent auditor. Issuers are required to disclose the aggregate fees that are billed in the latest two fiscal years. Another requirement is a one-year cooling-off period for audit engagement team members to accept employment at a client in a “financial reporting oversight role” [Ernst & Young, 2003, p. 10]. SOX also imposes a maximum of five consecutive years of service for lead and concurring partners and seven years for other engagement team partners.

Another new rule from the SEC is mandatory communication from the auditor to the audit committee prior to filing an audit report disclosing [Ernst & Young, 2003, p. 13]:

All critical accounting policies and practices to be used; all alternative treatments within generally accepted accounting principles for policies and practices related to material items that have been discussed with management of the issuer; and other written communications between the independent auditor and the management of the issuer.

In late 2004, effective in 2005, the AICPA updated the Code of Professional Conduct’s Independence Interpretation 101-3 and Outsourcing Professional Services. Independence Interpretation 101-3 was updated in the following three areas: client agreement of its responsibilities, documentation requirements, and applicability of the client agreement and documentation requirements. Outsourcing professional services added three new ethics rulings to the AICPA Code of Conduct. All these updates relate to the sixth criterion, consulting and management advisory services.

**Summary:** Despite major changes in independence rules during this period, no new edition of the Montgomery textbook has been published. These major changes are related to partner and staff rotation, which is becoming mandatory, and prohibition of performing most management advisory services on the part of external auditors.
CONCLUSION

Table 2 presents a summary of how the independence criteria, as identified in Table 1, are covered in different editions of the Montgomery textbooks discussed in this paper.

Prior to 1915, Montgomery textbooks emphasized state of mind, in addition to some discussion of other independence criteria. Rules of the AIA on professional ethics, eight of which appeared in 1917, are first recounted in the 1921 textbook. The word, “independence,” first appeared in the 1934 edition of the text. Although the Federal Trade Commission discussed “independence in fact” in 1933, that term did not appear in Montgomery until 1957.

Official guidelines with regard to independence appeared in 1947 in the Statements of Auditing Standard and were discussed in the 1949 edition. While greater emphasis was given to ownership, employment, and other interests in the 1957 edition, no attention was given to others, especially management advisory services despite its increase during this period. Independence in appearance was not mentioned in Montgomery's textbook until 1975, despite the fact that the 1962 Code of Professional Conduct included a rule to that effect. It should be noted that “independence in appearance” was officially included in the 1973 AICPA's RPC.

Independence was discussed in more detail in the 1987, 1990, and 1998 editions of Montgomery's textbooks covering most of the criteria that would impair independence. Still, the status of management advisory services (MAS) remained unchanged despite increases in these types of services by public accounting firms. Through the 1990s, MAS became the services provided by public accounting firms that produced the most debate over auditor independence. The failing of several companies in the early 21st century caused Congress to institute SOX, which drastically changed independence rules with respect to MAS and auditor rotation.

Generally, new developments in the area of independence took several years to be included in the textbook. There was typically a lag in publishing the Montgomery textbooks, and many of these textbooks were well out-of-date before the new editions were published. In addition, no new edition of the textbook has been published since 1998 despite monumental changes taking place post-2000.

The untimely inclusion of independence changes suggests that accounting students may not have received up-to-date
TABLE 2  
Summary of Independence Coverage in the Montgomery Textbooks

<table>
<thead>
<tr>
<th>textbook edition</th>
<th>Independence Criterion</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>state of mind</td>
</tr>
<tr>
<td>Pre-1915</td>
<td>tact, caution, firmness, fairness, courage, integrity, discretion, industry, judgment, patience, clearheadedness, and reliability</td>
</tr>
<tr>
<td>1915</td>
<td>no contingent fees</td>
</tr>
<tr>
<td>1921</td>
<td>be cautious of accepting favors and presents</td>
</tr>
<tr>
<td>1927</td>
<td>moral responsibility in relation with the clients, investors, lenders, business community, fellow members, and employees</td>
</tr>
</tbody>
</table>
TABLE 2 (continued)

Summary of Independence Coverage in the Montgomery Textbooks

<table>
<thead>
<tr>
<th>textbook edition</th>
<th>Independence Criterion</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td></td>
<td>state of mind</td>
</tr>
<tr>
<td>1934</td>
<td>same as 1927; absolute honesty</td>
</tr>
<tr>
<td>1940</td>
<td>same as 1934</td>
</tr>
<tr>
<td>1949</td>
<td>same as pre-1915; absolute honesty; objectivity; independence in mental attitude</td>
</tr>
<tr>
<td>1957</td>
<td>same as 1949</td>
</tr>
<tr>
<td>1975</td>
<td>same as 1949</td>
</tr>
</tbody>
</table>

| 1st edition | 1934; 1st textbook edition | 1927; absolute honesty |
|-------------|-----------------------------|
| 2nd edition | 1940; same as 1934 | 1921; no auditor can be an officer, director, or stockholder nor participate in activities or profits of the business |
| 3rd edition | 1949; same as 1949 | no direct or indirect financial interest in the client |
| 4th edition | 1957; same as 1949 | 1934; No direct or indirect financial interest in the client |
| 5th edition | 1975; same as 1949 | 1949; no direct employment relationship |

1934 same as 1927; absolute honesty same as 1921; no auditor can be an officer, director, or stockholder nor participate in activities or profits of the business.
<table>
<thead>
<tr>
<th>Textbook edition</th>
<th>Column 1</th>
<th>Column 2</th>
<th>Column 3</th>
<th>Column 4</th>
<th>Column 5</th>
<th>Column 6</th>
<th>Column 7</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>state of mind</td>
<td>indebtedness to clients</td>
<td>ownership, employment, and other interest</td>
<td>disputes with clients</td>
<td>partner and staff rotation</td>
<td>consulting and management advisory services</td>
<td>audit fees</td>
</tr>
<tr>
<td>1987</td>
<td>same as 1949</td>
<td>same as 1975; no commissions</td>
<td>no direct or indirect financial interest in the client; no direct or indirect employment relationship; no contingent fees</td>
<td>past due fees</td>
<td>no requirement on the rotation of auditors as per the Cohen Commission</td>
<td>no accounting service to public companies; other non-audit services are not prohibited by the AICPA or the SEC</td>
<td>protection for the auditor from management influence through audit committee; a discussion of transfer to public sector</td>
</tr>
<tr>
<td>1990</td>
<td>same as 1949</td>
<td>same as 1975; no commissions</td>
<td>no direct or indirect financial interest in the client; no direct or indirect employment relationship; no contingent fees</td>
<td>past due fees</td>
<td>rotation of partners; rotation of audit personnel</td>
<td>no accounting service to public companies; other non-audit services are not prohibited by the AICPA or the SEC</td>
<td>protection for the auditor from management influence through audit committee; a discussion of transfer to public sector</td>
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<td>protection for the auditor from management influence through audit committee; A discussion of transfer to public sector</td>
</tr>
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</table>

Source: Montgomery textbooks (1st through 12th editions)
information with regard to independence issues. Of course, supplemental materials could fill the gaps depending upon the instructor’s willingness to incorporate such materials. However, the availability of additional teaching materials may have been a significant problem in the 20th century, at least before the introduction of computers and the Internet.

It should be noted that this paper considers only the Montgomery textbooks. Other auditing texts, which may have covered the concepts of independence and ethical values in greater detail, were not generally published until later in the 20th century. It is the longer series that makes the use of Montgomery’s textbooks more relevant to an analysis of auditor independence. In addition, a study could be conducted to see if the lengthy Dicksee series of audit texts reflects the same patterns as Montgomery’s. Such a comparative project could judge the attitudes of U.K. and U.S. accounting professionals towards the importance of ethics education.6

REFERENCES

Primary Sources:


6 We would like to thank an anonymous reviewer for pointing out this possibility.

Secondary Sources:

**APPENDIX A**

**HISTORY OF INDEPENDENCE 1887-2005**

<table>
<thead>
<tr>
<th>Year</th>
<th>Description of Event</th>
</tr>
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<tbody>
<tr>
<td>1887</td>
<td>American Association of Public Accountants was established, but did not originally include independence in its constitution or by-laws.</td>
</tr>
<tr>
<td>1900</td>
<td>The concept of independence began to appear in accounting literature.</td>
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<tr>
<td>1915</td>
<td>An issue developed from a situation where a public accounting firm was auditing statements of a company in which a member of the firm was also the internal auditor.</td>
</tr>
<tr>
<td>1926</td>
<td>The report of the American Institute of Accountants’ (AIA) Committee on Professional Ethics posed the question of whether it is ethical for a CPA who is a director of a company to also certify the company’s balance sheet.</td>
</tr>
<tr>
<td>1928</td>
<td>The question of an auditor who was also a stockholder surfaced; the word <em>independence</em> was still not included in the Rules of Professional Conduct.</td>
</tr>
<tr>
<td>Year</td>
<td>Event</td>
</tr>
<tr>
<td>------</td>
<td>-------</td>
</tr>
<tr>
<td>1933</td>
<td>The Federal Trade Commission adopted a rule that any CPA or public accountant would not be recognized as independent unless he/she was, in fact, independent.</td>
</tr>
<tr>
<td>1934</td>
<td>The Security and Exchange Commission (SEC) was formed and prohibited any financial interest in the company being audited; the AIA passed a resolution prohibiting a “substantial financial interest.”</td>
</tr>
<tr>
<td>1936</td>
<td>The SEC rule was amended to agree with the position of “substantial financial interest.”</td>
</tr>
<tr>
<td>1937</td>
<td>The SEC issued Accounting Series Release (ASR) No. 2, “Independence of Accountants: Relationship to Registrant,” which described specific cases in which accountants were not considered independent.</td>
</tr>
<tr>
<td>1940</td>
<td>The AIA adopted a rule of professional conduct regarding financial independence to replace its 1934 resolution.</td>
</tr>
<tr>
<td>1941</td>
<td>The SEC issued ASR No. 22, “Independence of Accountants: Indemnification by Registrant,” which states that the main objective of total independence is to assure the impartiality and objectivity needed in an audit and that any circumstances which might bias the mind of the auditor may be considered evidence of the lack of independence.</td>
</tr>
<tr>
<td>1942</td>
<td>The AIA rule adopted in 1940 was modified; independence was considered impaired if the auditor or his immediate family had financial interest in an enterprise that was substantial to his capital or his own personal fortune.</td>
</tr>
<tr>
<td>1947</td>
<td>The AIA specifically defined independence, in its “Tentative Statement of Auditing Standards,” as a state of mind; an impartial attitude regarding the auditor’s findings and noted key characteristics of the independence concept as honest disinterest, unbiased judgment, objective consideration of facts, and judicial impartiality; thus, Rules of Conduct only dealt with objective standards and, accordingly, independence could not be assured; basically, independence “in fact” is emphasized.</td>
</tr>
<tr>
<td>1950</td>
<td>The SEC amended its rule on independence by omitting the word “substantial” from the phrase “any substantial interest” due to debates over the essence of “substantial” financial interest.</td>
</tr>
<tr>
<td>1960</td>
<td>The American Institute of Certified Public Accountants (AICPA) Committee on Professional Ethics proposed to amend the Rules of Conduct to prohibit any member from serving as an employee or director of a firm for which he was the auditor or from having any financial interest in such a firm.</td>
</tr>
<tr>
<td>1961</td>
<td>The 1960 proposal was voted on and passed at the AICPA’s annual meeting.</td>
</tr>
<tr>
<td>1963</td>
<td>The AICPA Committee on Professional Ethics issued Opinion no. 12, “Independence,” which stated that it was ethical to offer management advisory and tax services.</td>
</tr>
<tr>
<td>1966</td>
<td>The AICPA appointed a special ad-hoc committee on independence to study whether the provision of management services tended to impair audit independence.</td>
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</tbody>
</table>
The AICPA ad-hoc committee reported that it had not found any substantive evidence that the provisions of management services had, in fact, impaired independence; the committee, however, suggested the use of the audit committee of the board of directors to deal with questions relating to appearance of independence and management services.

The SEC issued ASR No. 126, “Independence of Accountants: Guidelines and Examples of Situations Involving the Independence of Accountants,” which covered guidelines for determining the existence of independence; situations in which independence could be challenged, as well as several statements concerning specific circumstances which would or would not impair independence.

The AICPA adopted new rules of conduct (Rule 101), which required accountants to issue opinions about fairness of presentation of financial statements only if they are independent both “in fact” and “in appearance.”

Rule 101 was modified slightly; the status management accounting services remained unchanged through the 1990s.

The Independence Standards Board (ISB), a private sector body, was formed to provide a conceptual framework for independence issues related to audits of public companies.

The ISB issued Standard No. 1, “Independence Discussion with Audit Committees,” which requires the auditor to provide the audit committee a written description of all relationships between the auditor and the company that, in the auditor’s professional judgment, may reasonably be thought to bear on independence. It also issued Standard No. 2, “Certain Independence Implications of Audits of Mutual Funds and Related Entities,” which was amended in July 2000.

The ISB issued Standard No. 3, “Employment with Audit Clients,” which describes safeguards that firms should implement when their professionals accept employment with clients.

The ISB was dissolved; the SEC issued “Revision of the Commission’s Auditor Independence Requirements,” which, for the first time, explicitly considers independence “in appearance,” and places limits on management accounting services including internal audit and appraisal/valuation services, but permits tax services subject to pre-approval by the audit committee.

The Sarbanes-Oxley Act was signed into legislation, which established the Public Company Accounting Oversight Board (PCAOB) appointed and overseen by the SEC.

The SEC adopted rules “Strengthening the Commission’s Requirements Regarding Auditor Independence” consistent with the requirements of the Sarbanes-Oxley Act, which further restrict the provision of consulting services to audit clients, include restriction on employment of former audit firm employees by the client, and require audit partner rotation to enhance auditor independence.

The AICPA made changes to the Code of Professional Conduct regarding Independence Interpretation 101-3 and outsourcing professional services.

Source: Younkins (1996) and Loscalzo et al. (2005)
NEPALESE GOVERNMENTAL ACCOUNTING DEVELOPMENT IN THE 1950s AND EARLY 1960s: AN ATTEMPT TO INSTITUTIONALIZE EXPENDITURE ACCOUNTING

Abstract: This paper aims at disseminating knowledge about the evolution of expenditure accounting in the government of Nepal. In doing so, the paper examines emerging ideas in the aftermath of the political change of 1951 in Nepal, and traces the processes of development and institutionalization of expenditure accounting during the course of two decades, the 1950s and early 1960s, with particular reference to the institutional forces at work. An interesting feature of Nepalese accounting reforms before and after the political change was the active participation of India, the United Nations, and the U.S. Agency for International Development (USAID). At the outset of the post-Rana period, Indian advisors dominated the reform process and helped Nepal introduce and incorporate a range of modern administrative measures, including a new budgeting structure called line-item budgeting. The external influence on Nepal’s reforms and the ways of installing new values in the administration altered in the second half of the 1950s. The United Nations and the USAID became the major agents in the introduction and institutionalization of rules and practices, especially accounting norms and procedures.

INTRODUCTION

This paper aims at disseminating knowledge about the evolution of expenditure accounting in the government of Nepal. In doing so, the paper examines emerging ideas in the aftermath of

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the political change of 1951 in Nepal and traces the processes of development and institutionalization of expenditure accounting during the course of two decades, the 1950s and early 1960s, with particular reference to the institutional forces at work. The paper draws on institutional mechanisms to describe and analyze how accounting norms and practices evolved and were disseminated in the government of Nepal. In recent years, a significant number of studies have underlined the importance of applying perspectives from institutional theories to provide understanding as to why accounting changes and the ways new accounting ideas are context dependent [Hopwood, 1983, 1987; Miller, 1994; Carmona and Macías, 2001]. This study, focusing on the evolution of expenditure accounting in the government of Nepal, intends a contribution to this literature.

There is little research addressing Nepalese government accounting history. In the context of accounting history, Nepal may be of special interest due to its isolation. The Rana family, who governed Nepal for more than a century under total dictatorship, isolated Nepal from many of the changes taking place throughout the world, even in nearby India. This isolation contributed to the independence of Nepal but, at the same time, pushed the country back to the medieval age in terms of socio-economic development. Consequently, prior to the political change in 1951 that replaced the Rana family with the king, Nepal was a closed, highly illiterate, and very underdeveloped, agricultural-based economy with no industrialization. At the beginning of the 1950s, only 2% of the adult population was literate, less than 1% was engaged in modern industrial occupations, and 85% of employment and income came from agriculture, mostly performed by tenants using archaic methods [Adhikari, 2005].

The decade of the 1950s marked the point of departure as Nepal replaced its policy of isolation with international integration and modernization. As a result, the country appeared on the world’s political map as a new nation albeit lagging far behind other open societies both socio-economically and administratively. In the 1950s, substantial efforts were made to introduce new values and techniques in public administration. New state institutions as, for example, the Accountant General’s Office (AGO) and the National Planning Commission, were established. According to Joshi [1973], the Rana’s policy of disintegrating people from politics and administration had created a dearth of trained personnel who could model and implement the new administrative structures. The lack of resources and technical ex-
pertise also meant that Nepal was left with no other alternatives than to rely upon foreign consultants and international grants and aid to fund the process of transforming itself into a modern state. Without international participation, many new initiatives in public administration would have been impossible [Rose and Landau, 1977].

An interesting feature of the Nepalese accounting reforms introduced after the political change was the active participation of India, the United Nations (UN), and the U.S. Agency for International Development (USAID). At the outset of the post-Rana period, Indian advisors dominated the reform process and helped Nepal introduce and incorporate a range of modern administrative measures, including a new budgeting structure called line-item budgeting [Shrestha, 1965; Gongal, 1973; Joshi, 1973]. The external influence on Nepal’s reforms and the ways of installing new values in the administration altered in the second half of the 1950s. The UN and the USAID became the major agents in the introduction and institutionalization of rules and practices, especially accounting norms and procedures [Gongal, 1973].

As stated previously, both the methodological approach to the material studied and the reporting structure of the findings is inspired by institutional theories. There are different and sometimes conflicting understandings of what an “institution” is and what constitutes “institutionalization.” Selznick [1957] and Berger and Luckman [1967] posit a strong emphasis on issues such as “persistence and stability,” “normative and cognitive adaptation,” and “a shared social reality” in order to define the construction and continuation of institutions in a particular context. Meyer and Rowan [1977] couple the concept of institutions to a variety of elements connected to the existence of organizational structures. They argue that organizations may choose those requirements and practices that are regarded as valuable in a society, not because they will necessarily result in greater efficiency. Rather, such requirements and practices may be important to demonstrate rationality and modernity in a wider environment [Scott, 1987]. According to Dambrin et al. [2007], organizations attempt to respond to institutional requirements and practices in a number of ways, ranging from active adoption to minimal adoption and ceremonial adoption, so-called “decoupling.” In reality, however, organizations do not adapt institutional ideas and practices either following an exact format or in an intended way. Organizations select relevant concepts from a myriad of ideas circulating in their institutional
environment and endeavor to translate them in accordance with the specific organizational contexts [Czarniawska and Sevon, 1996; Andersson and Engwall, 2002]. According to this view, the ideas and practices in a particular context may have special flavors and qualities which are supposed to contribute to local constructions.

Our aim in this paper is not to identify the strengths and weaknesses of these different perspectives on institutions. Instead, we argue that an extensive focus on a particular version of institutions may weaken our effort to unfold a picture of the evolution of Nepalese expenditure accounting. Apart from drawing on ideas from these perspectives on institutions, we are also applying DiMaggio and Powell’s [1983] idea of how organizations strive to comply with institutional requirements in framing rules and practices, i.e., through coercive, mimetic, and normative mechanisms. This technique of applying institutional theories to understand what has happened when accounting is changed has been fruitfully applied by other researchers [Carmona and Macías, 2001; Carmona and Donoso, 2004].

The remainder of this paper is organized as follows. The following section presents a short introduction to the political and administrative environment in the 1950s. Section three describes the evolution of the budget system. The intent in that section is to create a background for understanding how the crisis in public finance led to the development of expenditure accounting. This development is discussed in the fourth section, with the institutionalization of accounting in Nepal’s government covered in the fifth section. Thereafter, there is a theoretical discussion and a conclusion in which the need for further research into the accounting development of the Nepalese government is addressed.

THE POLITICAL AND ADMINISTRATIVE ENVIRONMENT: THE BEGINNING OF A NEW ERA

Nepal was established as a single kingdom in 1768 after the unification of small, desert principalities under the auspices of the shah king, a ruler of one of the principalities. In 1846, taking the benefit of rising internal conflicts among the ruling shah’s family members, the Rana family seized state authority from the monarch, inheriting the position of prime minister with unlimited power on the basis of a primogeniture rule of succession. Growing agitation against the autocratic rule inside the country and external developments internationally, especially India’s in-
dependence and its support of Nepal’s democratic process, could be credited with weakening the Ranas’ control in politics in the late 1940s. It was within this context that Nepal witnessed a political revolution that ended the century-long dictatorship of the Rana oligarchs. This political change which took place in 1951 introduced the king and political parties into mainstream politics. In fact, a major political agenda in the 1950s was to hold an election for the Constitutional Assembly with the power to establish a multi-party democracy and a constitutional monarchy [Shrestha 1964; Joshi, 1973]. In the aftermath of the political change, however, Nepal experienced unprecedented political unrest due to the failure of this political goal to materialize. The king’s unwillingness to delegate authority to the political parties ushered in the start of a period with a strong active monarchy that lasted until the movement for democracy in 1990.

Despite the failure to institutional a multi-party democracy, the political change of 1951 led the country to an era of socio-administrative reforms. However, Nepal’s inexperience in public governance, as well as a lack of economic and human resources, implied that the country was not able to cope with the rising demands for modernization. At the outset, Nepal asked for guidance from India in its endeavor to introduce new administrative norms and frameworks [Poudyal, 1991]. Since India had been a part of the British Empire, which Nepal never had been, India’s guidance was indirectly influenced by the British. The Indian consultants, as claimed by Gongal [1973], helped the government create bureaucratic administrative machinery such as ministries and departments. Among the Indian consultants, the Buch Committee seemed to be very influential in driving Nepal’s administrative modernization [Joshi, 1973].\(^1\) What was striking, however, was a growing conflict between the Indian consultants and Nepalese government officials in subsequent years. According to Joshi [1973], the conflicts escalated because the Indian consultants to a large extent excluded Nepalese officers in the process of implementing the new administrative measures. Seemingly, their intention was to elevate Nepal’s dependency on India for resources and technical expertise [IIDS, 1998].

\(^1\) The first batch of Indian consultants that arrived in Nepal just after the political change consisted of senior members of the Indian civil service. They were J.M. Shrinagesh and Birj Narayan. Govinda Narayan and S.K. Sinha accompanied the team after some months. In 1952, India replaced this team by the Buch Committee. The Buch Committee was composed of N.M Buch (then secretary of the Indian Ministry of Home Affairs), K.P. Methrani (Indian civil servant), and S.K. Anand.
The impact of India in the administrative reforms diminished after Nepal extended its diplomatic relationships with other countries. Nepal's membership in the UN in the second half of the 1950s provided the country with an opportunity to introduce itself in an international arena. This seemed to be a turning point in Nepal's ongoing administrative modernization. With increased development grants and aid, the UN and the USAID endeavored to exert their influence over Nepalese administrative reforms. Unlike India, these agencies prioritized the capacity enhancement of Nepalese officials in order to make them acquainted with modern approaches to governance. Joshi [1973] cites the contribution of the UN's advisors and trainers – Walter Fischer, Frederick W. Gray, Eric Himsworth, Howard Kumin, J.F. Luba, Harving L. Nissen, Harry B. Price, Soren Stogaard, Ejler Alkjaer, and Kunt Palmstran – in Nepalese administrative modernization and the capacity development of government officers. According to Gongal [1973], the UN and the USAID had a particular focus on financial-sector reforms. The financial sector was lacking basic infrastructure; for instance, an accounting system and skilled accountants. Moreover, it was conceived as an area hindering the smooth operation of the entirety of Nepalese public administration.

**THE EVOLUTION OF THE BUDGET SYSTEM: THE BEGINNING OF FINANCIAL INSTABILITY**

As stated previously, the political change embraced a new ideology in Nepal, emphasizing development and modernization in all aspects of socio-economic life. As a result, there emerged a strong body of opinion in favor of managing expenditures, especially development expenditures, more effectively and transparently. Considering Nepalese history, a main concern of financial administration seemed to be confined to revenue management [Adhikari, 2005]. Gongal [1973] argues that a reason for this could be the prerogatives inherited by the rulers to personalize the national treasury, especially collected revenues. Throughout the country's history, the rulers strove to maintain stringent control over the incurring of expenditures and the collection and write-off of revenues. According to Chatterjee [1967], the Rana prime ministers were probably the most notorious illustration in this regard. They maintained financial control coercively that could hardly be found in other South Asian counties. During their century-long tenure, any defaults in public funds or errors in accounting were transferred to the defaulter's successive gen-
Gongal [1973, p. 85] notes that, “any default in public funds or errors in accounting was the responsibility not only of the defaulter but also of his heirs up to the seventh generation.”

In the altered environment of the 1950s, the budget was conceived as a means of accommodating and managing expenditures in a planned way. One of the specific features of the interim constitution, enacted in 1951, was the incorporation of the budget system and a provision for a financial comptroller. Indeed, the evolution of a budget marked a pivotal milestone in the development of Nepalese financial administration. In 1952, the first budget of the government of Nepal was presented [Sharma, 1996]. Joshi [1973] identifies the role of the Buch Committee in designing the budgetary items and enunciating the idea of forecasting based on previous budgets. The introduction of five-year planning in 1956, however, led to some changes in the budget structures. A system of dual budgeting was then presented by segregating expenditures into regular and development expenditures. While the regular budget mostly included the government’s operating costs, the development budget was meant to track international grants and aid.

Himsworth [1959] argues that the budgets issued by the government of Nepal during the 1950s could not be referred to as a “budget” in the sense that the word is understood in western countries. The budget in practice neither reflected fiscal policies nor expenditure control. Salaries, wages, and other expenditures continued to be released in an ad-hoc manner without any reference to the budget document [Pradhananga, 1956]. In fact, what was meant by the budget in Nepal was an abstract of estimated revenues and expenditures that the Ministry of Finance used to prepare by the end of the financial year. Moreover, given the time at which the budgets were prepared, they had no impact on expenditure control. According to Himsworth [1958, p. 39]:

The budget does not represent in statistical terms the policies of the government for the year. The main object of the budget seems to have been to facilitate the ad hoc agreement to an item of expenditure; for if such item has been anticipated by being incorporated in the draft document, the officials of the ministry of finance will find it easier to sanction such item of expenditure than if it had not been previously considered when the budget document was compiled. This is the sole practical use of the budget.

Indeed, inadequate knowledge and limited capacity in
managing financial administration, a lack of trained accountants and bureaucrats, and the absence of regulations and procedures were the core reasons exacerbating budget practice in Nepal [Himsworth, 1959; Chatterjee, 1967; Wildavsky, 1972; Singh, 1977]. A further acknowledged constraint on the implementation of budget was the presence of the revenue-oriented accounting systems. Bista [1964] argues that the accounting systems in use were proved to be deficient both in terms of design and applicability. Given the design, they were modeled to meet the necessities of a feudal state in which the focus was on maximizing revenues and limiting expenditures. According to Bista [1964], the traditional hand-made accounting forms used in the systems failed to deal with extended public activities and government expenditures funded by international aid. In terms of applicability, the prevailing accounting systems were not integrated with the budget as they were in practice prior to the implementation of the budget system. They failed to offer consistent ways of tracking the movement of cash flows and budget expenditures. Price [1961] states that there was a complete lack of accounting information about the collection and disbursements of government funds pre-1959.

As a result of these weaknesses in the accounting systems, budget implementation remained largely decoupled in practice. Instead of improving financial administration, the introduction of budgets actually weakened accountability and led to financial instability in Nepal. There was growing condemnation of government expenditures and the unsatisfactory state of the government accounts. Such shortcomings rendered it difficult for international organizations to assess the progress of development expenditures offered in the form of grants and aid. It was in response to these concerns that the UN launched a survey, the first of its kind, on the Nepalese financial sector and attempted to find ways to improve the existing financial environment [Himsworth, 1959]. The survey result signaled the need for the replacement of the old accounting systems in order to maintain consistency between accounting and budgeting. H. Price, another UN economic expert, while conducting the economic survey of Nepal in 1961, expressed a more or less similar opinion, emphasizing the need to regulate expenditure accounting in order to improve the fiscal environment [Adhikari, 2005]. By the end of the 1950s and early 1960s, the government was encountering tremendous normative pressure to streamline the operation of its accounting. Griffenhagen-Kroeger [1962] states that accounting-sector reforms became a widespread concern.
both inside and outside the country. In fact, improvements in the accounting systems were acknowledged as a prerequisite for maintaining control over Nepalese financial administration.

**THE SEARCH FOR AND DEVELOPMENT OF BUDGET ACCOUNTING: A COLLECTIVE ENDEAVOR**

The reform initiatives mounted in Nepal in the 1960s differed from those attempted in the previous decade. While public administration and budgeting were atop the reform agenda at the beginning of the 1950s, accounting change dominated the reform agenda in the 1960s. While accounting-sector reforms were prioritized, there was a shortage of trained accountants and professional bodies inside the country to help effectuate the proposed reforms. Assistance was therefore sought from international organizations and donor countries. In fact, international agencies were strongly involved in the search for a new accounting. At the outset, Nepal was aided by the UN, whose motive was a desire to bring expenditure under tight control. The USAID dominated the accounting-sector reforms in subsequent years and played a crucial role in the institutionalization of the expenditure-accounting system in the government of Nepal.

The UN appointed J.F. Luba as an accounting advisor for Nepal in the late 1950s [Gongal 1973]. No information about Luba, his prior career, status, and background, was revealed in the Nepalese accounting literature. However, it is assumed that Luba had a career in the UN as a financial consultant. Gongal [1973] states that Luba's task was primarily to aid the government in the setting of financial rules and accounting procedures. The absence of detailed regulations had caused considerable heterogeneity in the recording and reporting of budget expenditures. In 1959, a new financial norm was enacted by covering general procedures for releasing and reporting budgets. In fact, the spending units were proposed to disburse budget allocations on a quarterly basis through appropriate line ministries [Chatterjee, 1967]. Prior to the issuance of this norm, the spending units were provided with money directly through the Ministry of Finance without any reference to the respective ministries. The norm was therefore intended to empower the line ministries by providing a machinery to maintain control over spending on the part of their subordinate units. In addition to budgetary norms, Nepal witnessed, at the same time, an initial effort to revitalize its accounting systems. The UN proposed a so-called “payment accounting system,” which adhered to a double-entry
methodology. The system put a greater emphasis on recording budget expenditures and reporting them to line ministries on a monthly, quarterly, and annual basis. Moreover, it consisted of provisions for freezing unspent money at the end of the budget year and internal auditing to uphold the underlying personal accountability of government officers. In 1960, the three main ministries at that time – the ministries of education, health, and parliamentary affairs – were selected to experiment with this new form of payment accounting. Despite commitment, the UN could not offer adequate experts and trainers who could impart knowledge on these new accounting approaches to government accountants [Pradhananga, 1964; Bhat, 1991]. Price [1961] points out two major factors hindering the experimentation of the payment-accounting system – a shortage of trained accountants and the continuation of deeply rooted, traditional accounting procedures.

Importantly, the failure of payment accounting meant that the accounting-sector reforms remained at the heart of the reform agenda. At the beginning of the 1960s, the Nepalese financial sector witnessed another substantial effort to streamline its accounting. What was striking this time was that, in addition to the UN, the USAID was also involved. On May 12, 1961, an accounting-reform project was formally announced. Chaired by the auditor general, the project consisted of three other members, including the under-secretary of the foreign-aid department of the Ministry of Finance, an accounting expert of the UN, and the public-administration advisor of the USAID (Nepal). In fact, the coming together of the USAID, the UN, and the government heralded the beginning of a new era in Nepalese government accounting reform. Griffenhagen-Kroeger [1962, p. 48] reiterates this fact: “There has been an unusually fine demonstration of coordination through a joint committee, of the accounting talents of the USAID accounting advisor, the staff of the UN, and representatives of His Majesty’s Government in working out a new accounting system.”

According to Lohani [1964], the members of the accounting-reform project team spent almost six months studying the feasibility of different accounting models that could be utilized in Nepal. On November 3, 1961, the accounting-reform project submitted its report to the finance secretary and the auditor general, recommending a new accounting system referred to as the expenditure-accounting system [Munkarmi and Pradhan, 1993]. This system retained the essential features of earlier payment accounting [Bista and Shrestha, 1996]. An important aspect of
the new accounting was the use of the cash principle and the double-entry bookkeeping (DEB) technique [Donnalley, 1967; Gould, 1969]. Referring to the accounting manual, published by the AGO in 1962, “the new accounting system was aimed at strictly maintaining the limitations set by the budget and generating adequate data for the preparation of the forthcoming budgets.” We could thus see that the motive of the DEB introduced in Nepal was to achieve greater control over resources, especially development grants and aid. International organizations literally envisaged double instead of single-entry bookkeeping as the means to achieving better accounting.2

Moreover, the form of DEB introduced in Nepal appears very much stewardship-oriented. Accounting was maintained at two different levels – the central and operating levels [Shrestha, 1986]. Central-level accounting, which was to be furnished by the ministries and departments, dealt with the transfer of money to spending units in accordance with their budget classifications and their reporting to the Ministry of Finance and the AGO. From this point of view, the purpose of central-level accounting was to scrutinize the accounts submitted by the spending units and then to adjust them in the ministerial or departmental statements [Cooper, 1963]. In contrast, operating-level accounting, which was to be kept by the spending units, aimed at maintaining budgetary limits and recording budget expenditures in accordance with the line items [Cooper 1963; Gould, 1969]. Looking at the structure and content, the principal books kept in operating-level accounting were a cash book, a budget sheet, a journal, and a ledger maintained on the double-entry principle. In addition, a miscellaneous book was also recommended in order to track money paid in advance to employers and contractors [Cooper, 1963].

The accounting system recommended by the accounting-reform project was approved by the auditor general on February 2, 1962 [AGO, 1962]. On July 15, 1962, this new accounting was experimentally employed for the first time in the development programs undertaken in the Kathmandu Valley region [Lohani, 1964]. Because of the importance of interlinking accounting and budgeting while reinforcing the accountability of develop-

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2Edwards et al. [2002] show a more or less similar reason for introducing DEB in Britain’s central government in 1829. Accordingly, achieving a better accounting was seen to involve the adoption of double rather than single-entry bookkeeping and accruals in place of cash-based record keeping and financial reporting (p. 637).
ment expenditures, both the national and international efforts combined in seeking a new accounting. The construction of the new accounting could therefore be seen as a collective endeavor rather than a purely internal exercise. Indeed, the introduction of the new accounting was an important starting point for a modern version of recording and reporting expenditures in Nepalese governmental accounting.

THE INSTITUTIONALIZATION OF THE NEW ACCOUNTING: THE BIGGEST TRAINING PROJECT

According to Donnalley [1967], the simplicity of the new accounting system in managing cash and development expenditures was highly praised by international organizations and donors. This new version of accounting seemed sufficient to meet their information needs [Griffenhagen-Kroeger, 1962]. In spite of the widespread support, the use of the cash-basis principle and the extensive focus on expenditure management highlighted some practical flaws in the accounting system. In fact, the cash basis employed in the new accounting ignored the recording of fixed assets, obligations and commitments, and debtors and creditors. Moreover, the emphasis on expenditures led to a deficiency in accounting for revenues, deposits, public works, and foreign grants [Chatterjee, 1967].

Interestingly, the introduction of the new accounting sparked a debate in the Nepalese political and administrative arena where the relevancy of the double-entry methodology was questioned [Chatterjee, 1967]. The majority of accountants and other government bureaucrats had been recruited by the Ranas based on nepotism and various forms of patronage, as in Britain in the early 19th century [Edwards et al., 2002]. They lacked the formal education and training required for the discharge of their assigned duties. In addition, the accountants were not acquainted with DEB and other new approaches of the system [Gould, 1969]. In the absence of adequately trained accountants and resources, the institutionalization of the new accounting was an arduous endeavor [Fischer, 1958]. This was evident also in the statement of Gould [1969, p. 1], who served as a USAID advisor to Nepal: “Although relatively simple, the system is sufficiently complex to require that the employee maintaining the accounts have some accounting skill and training.”

However, the failure of payment accounting had taught some lessons and had delineated the need for an intensive training program prior to the introduction of new accounting tech-
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Techniques and concepts in Nepal. To make the institutionalization successful, the AGO sought assistance from international organizations and donor countries in articulating a training program for government accountants and officers [Bista, 1964]. Within this context, in 1962, an agreement was signed between the AGO and the USAID continuing the accounting-reform project [Donnalley, 1967]. This agreement introduced the new accounting in phases, after conducting an adequate training program for government accountants. Donnalley [1967] observes that the accounting system took longer than expected, more than five years, in order to be institutionalized across the country. However, given the underdeveloped state of public administration in Nepal and the difficulties involved in reforming public accounting, five years could be seen as a rather short period of time. Similarly, Edwards et al. [2002] show that it took considerable time for the full-fledged application of double-entry in Britain. This new system of accounting, experimented with in the Kathmandu Valley region on July 15, 1962, penetrated the entire nation by the end of 1968.

After the agreement was signed with the AGO, the USAID appointed John A. Cooper as an accounting advisor to Nepal [Lohani, 1964]. Cooper was an American career civil servant acquainted with government-accounting models in developing countries. As gauged by Bista [1964], Cooper’s role in imparting accounting knowledge to government officers and institutionalizing the new accounting across the country was significant. Cooper guided the AGO in designing the training syllabus and phasing in the entire training program. The training program passed through three distinct stages. At the outset, the government accountants of the Kathmandu Valley region were summoned and offered training. The training was focused on educating them in the approaches to the new accounting, especially recording expenditures in accordance with double entry. At the second stage, a large number of accountants from different ministries, departments, and regional offices were called in for participation. The trained accountants of the Kathmandu Valley region were primarily engaged in disseminating knowledge on the concepts and techniques of the new accounting. In the last phase, all trained accountants were deployed in their home offices to implement the new system of accounting. In addition to training, the USAID organized a series of seminars for other government officers in order to bring them up to speed with the concepts of DEB [Gould, 1969]. As a matter of fact, the USAID Nepal, together with the AGO, performed most of the commit-
ments outlined in the agreement by the end of 1966. This joint accounting project of the USAID and the government turned out to be one of the largest training projects ever conducted in Nepal. Donnalley [1967, p. 2] indicates some of the major tasks completed during the four-year period:

- implementation of the new accounting system in twelve out of the fourteen zones of Nepal
- training of 4,565 accountants through in-service training classes
- facilitating the dispatch of accounting supplies and equipment to government offices in twelve zones
- publication and distribution of the manual of expenditure accounting, the handbook of property accounting, and guidelines for purchase procedures
- making available the first English-Nepali financial dictionary

Not all items contained in the agreement pact between the USAID and the government were accomplished. Standardizing revenue collection, introducing the double-entry methodology for recording revenues, and simplifying budget disbursement were among the processes that waned over time. A consequence of this was that only the expenditure side of the budget was addressed during the training period. The trainers attempted to identify the ways to deal with the recording and reporting of budget expenditures. Gould [1969] observes that Nepal’s undeveloped communication and transportation facilities, along with the general low level of accounting knowledge, were the major impediments to operationalize the other items agreed with the USAID. Moreover, these impediments made the continuation of the accounting-reform project an arduous endeavor.

Most notably, the government’s failure to motivate the trained accountants was another factor having an adverse impact on the accounting-training project. Gould [1969] notes that a large number of accountants, who were actually the products of the accounting training project, attempted to shift roles and transfer to other administrative sectors. This trend, however, was not due to the fact that the training of government accountants made them more marketable and able to secure better work elsewhere. A core reason was that the accounting profession in Nepal was held in low esteem, and the accountants had few opportunities for career development [Donnalley, 1967]. Accordingly, the supportive facilities of motivation and commitment, as well as the idiosyncrasies of being accountants, were low in
comparison to other administrative positions. More interestingly, government accountants were not embedded in the civil-service sector as bureaucrats. As a result, the trained accountants were interested in seeking a transfer to other administrative positions in order to avail themselves of additional tenure, retirement, and promotional advantages unavailable in the accounting sector. Gould [1969] points out that the lack of incentives had been a primary stimulus in promoting a high turnover rate as accounting personnel accepted other administrative positions. Approximately 30% of the accountants starting in the training project were no longer functioning as accountants by the time the training project ended [Donnalley, 1967; Gould 1969]. This shift to another sector created a paucity of skilled accountants despite the success of the accounting-training project.

DISCUSSION: UNDERSTANDING THE EVOLUTION OF EXPENDITURE ACCOUNTING

The decade of the 1950s was a point of departure for the modernization of Nepalese society. As a newly recognized nation on the world’s political map, Nepal was distant from other modern societies, lacking fundamental measures of administration and governance. A number of international institutions and experts, particularly from the U.S., the UN, and India, propagated and disseminated modern ideas and patterns to organize and manage Nepalese administration. They attempted to establish a bridge to connect traditional Nepalese society with the outside world, and they contributed greatly to Nepal’s quest for resources, stability, and legitimacy in its wider institutional environment. In the financial sector, a new ideology prevailed after the political change that emphasized the management of resources more effectively and efficiently. This transition in financial mentality from revenue to expenditure management meant a focus on budget execution. In this way, the budget and its execution became an institution demonstrating to all relevant external parties that the budget was a means of channeling resources.

Chan [2002, 2003] claims that an extensive focus on budget execution often demands a type of accounting that can measure and communicate budgetary performance. Taking this view into account, the search for a new accounting in Nepal in the 1950s and early 1960s could be seen as an endeavor to bring about control in the financial sector. Accounting, in that changed environment, was supposed to be conducive to executing budgets
and maintaining their limitations. The prevailing accounting systems were, however, premised on the ideology of managing revenues. Indeed, they were not designed to cope with expenditure planning and management. It was this factor that led to financial crisis in Nepal and resulted in international attention and participation in accounting-sector reforms.

The construction of the new accounting was a collective endeavor, incorporating the efforts of external agencies, particularly the UN, the USAID, and the Nepalese government. A lack of resources, experience, and expertise forced Nepal to request collective participation in the development of the new accounting. Despite international cooperation, the Nepalese environment, characterized by a low level of education and an underdeveloped infrastructure, played a significant role in altering the original accounting ideas and intended outcomes. According to Donnalley [1967], the new accounting system was distinct in comparison to the British and European models in spite of applying the principle of cash accounting and adopting DEB. The main difference was that unlike Britain and other European countries, DEB was applied in Nepal only for recording expenditures. The main purpose for DEB in Nepal was to achieve more effective control of budget expenditures, especially those expenditures sponsored by international organizations. As a result, the accounting for revenues, deposits, public works, and other important budgetary components continued in the traditional manner of single-entry bookkeeping, resulting in inconsistent methods prevailing throughout the governmental sector [Shrestha, 1986].

When considering the institutional mechanisms, the predominant role of the mimetic and normative mechanisms could be envisioned in the process of institutionalizing the new accounting. Indeed, the mimetic process had been the dominant institutional force, especially at the beginning of the 1950s. In the process of a transition from feudalism towards modernity, Nepal incorporated a rationalized administrative apparatus and a number of financial measures, such as the line-item budget. To be more specific, this was probably the only way to initiate administrative reforms because Nepal was lacking in both expertise and resources. In addition to this, the country was not exposed to its institutional environment, comprising donors and international organizations. The normative institutional determinant seemed to be a potent force, especially after Nepal’s admission to the UN in the second half of the 1950s. Many of the former financial structures, including the accounting sys-
tems, were literally the results of the joint projects undertaken with the UN and the USAID. These organizations contributed to implementing the reforms not only by offering resources and expertise but also by facilitating the training of Nepalese accountants and officers in the new accounting approaches and techniques. The existence of coercive mechanisms could not be denied since Nepal was largely dependent on the UN and the USAID for facilitating the reforms. In fact, it was important for Nepal to comply with the requirements of these organizations in order to secure resources and technical assistance. However, given the prevailing primitive conditions characterized by the lack of resources, trained personnel, and administrative apparatus, both the USAID and the UN collectively participated in the reform process rather than exerting pressure to enforce their ideas and recommendations. Their participation was meant to ensure that Nepal made the necessary accounting changes. The impact of the coercive mechanisms therefore seemed less potent in Nepalese government accounting reforms. As stated by Fein and Mizuchi [1999] and Carpenter and Feroz [2001], identification of one type of determinant for change at a particular point in time does not necessarily imply that the remaining two are absolutely ineffective. Whether this is the case or not, a conclusion can be drawn from Nepalese government accounting development that the pattern of institutionalization favored the more mimetic and normative forces.

CONCLUSION

This paper has examined an interesting and important episode in the history of Nepalese governmental accounting – an attempt to introduce and institutionalize expenditure accounting. The episode covered occurred in the period of transition from feudalism to modernity, a period when there was a shift of ideology in the financial sector from managing revenues to controlling expenditures. We have therefore endeavored to address events during a time of change and to examine the forces at work. Institutional perspectives have been applied in describing the development of expenditure accounting and discussing the role of international organizations and donor countries in Nepal’s accounting development. In fact, government accounting development in Nepal demonstrates a clear link between accounting and its operating institutional environment. A Nepalese attempt to develop an expenditure-accounting system, which was also credited with evolving a modern approach to
accounting and reporting, is seen as a response to demand expressed by the changing socio-political and institutional environment. The influence of external institutional factors, particularly the USAID and the UN, was notable in institutionalizing and disseminating the accounting concepts and techniques in the Nepalese formal structures. Indeed, the paper demonstrates that in order to comprehend the evolution of Nepalese expenditure accounting, a special reference to the existing context and institutional environment was a prerequisite.

Despite the effort to unveil Nepalese governmental accounting development, the paper has also opened up an avenue for further research, especially after the institutionalization of the new accounting in the late 1960s. The accounting development in Nepal reflects the fact that the extensive focus on budget expenditures allowed the USAID and UN to ignore many other important aspects of the budget and budgeting. As a result, several gaps were envisaged in the newly institutionalized accounting which forced the government to put an emphasis on the continuation of accounting-sector reform. Current accounting in the government of Nepal is an extended version of the expenditure accounting of the 1960s, with supplementary provisions on accounting for revenues, deposits, construction contacts, and foreign aid. Particular issues that need addressing by further research include how the government continued the accounting-sector reforms, and whether, how, and to what extent the institutional factors contributed to expanding the scope of expenditure accounting. Further exploration of the continuation of the U.S. and the UN’s involvement in the Nepalese accounting-sector reforms would also be interesting. It would be informative to see whether the UN and/or the USAID have performed similar services in other developing countries.

REFERENCES


Adhikari and Mellemvik, Nepalese Governmental Accounting


MAKING ACCOUNTING HISTORIANS

Abstract: This paper addresses the question of how accounting educators can “make” accounting historians or, more precisely, how educators can assist in fostering the development of historically aware accounting academics and practitioners. Various approaches to accounting history education are outlined, situated within the context of efforts to boost the membership of the community of accounting history scholars, redress deficiencies in accounting education, and engender the development of competent and broadly educated practicing professionals. The contributions and benefits of incorporating accounting history into accounting programs are overviewed, including an outline of past and contemporary examples of applications of accounting history in educational practice. A case study of the design and modeling of a graduate course in accounting history is then discussed and is offered as a prototype for use or adaptation by accounting educators interested in harnessing the potential of studies in accounting history to improve student learning experiences and learning outcomes.

INTRODUCTION

A brief overview of the table of contents in successive issues of the most notable journals publishing studies of accounting’s past, such as the Accounting Historians Journal, Accounting History, and Accounting, Business & Financial History, reveals something of the numbers of participants in, and extent of, the accounting history community, given the frequent recurrence of a relatively select few authors. An understanding of the profiles and publishing histories of these academics indicates that the accounting history community is currently composed of a largely mature faculty and these scholars “periodically express..."
concerns about the ageing” of their community [Guthrie and Parker, 2006, p. 8]. While Carnegie and Rodrigues [2007] and Guthrie and Parker [2006] provide evidence that accounting historians comprise a strong and flourishing group on a global basis, Fleischman and Radcliffe [2005, p. 85] characterize the U.S. segment of this community as experiencing “precipitous decline” [see also, Radcliffe, 2006]. Nevertheless, all of these commentators agree that attracting new, younger faculty to the community is a priority, and effort needs to be devoted to developing mechanisms to encourage and support the next and future generations of accounting history scholars. One means for doing so is through the work of various accounting history societies [Previts et al., 1990; Guthrie and Parker, 2006; Carnegie and Rodrigues, 2007], while another complementary avenue for encouraging interest in accounting history and the continued proliferation of historical accounting research, is through accounting history education.

In addition to bringing further academics into the fold, accounting history education has the potential to provide a range of other benefits. These benefits include promising opportunities for redressing deficiencies in accounting education programs in relation to content mastery, development of generic skills, and the quality of student learning experiences. More positively, opportunities exist for producing more well-rounded, informed, and critically aware accounting practitioners who are instilled with a sense of the importance and relevance of the history of their discipline to contemporary practice. In addressing these priorities, and noting Previts et al.’s [1990, p. 3] concern that there is a paucity of information about the place of accounting history within accounting pedagogy and “instruction in accounting history” and the more recent observation that there remain genuine weaknesses in “integrating accounting history into the curriculum” [Richardson, 2008, p. 268], the current paper provides a review of accounting history in accounting education and a discussion and modeling of the design of a graduate course1 in accounting history.

The remainder of this paper is presented in three sections. The following section examines the literature concerning the role of accounting history in accounting education. This review

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1A “course” is a teaching segment that is generally offered on a term or semester-long basis, alternatively called a subject, unit, or paper, as distinct from a program which represents a series of courses leading to an academic award such as a degree.
provides a context for the discussion of course design detailed in the next section. The final section of the paper offers some concluding comments concerning directions in accounting history education, potential applications of the course development blueprint, and suggestions for further research on the interface of accounting history and accounting education.

**ACCOUNTING HISTORY AND ACCOUNTING EDUCATION**

Concerns were raised about deficiencies in the state of accounting education by academics, professional accounting bodies, and employer groups during the 1980s and 1990s in many English-speaking nations. At issue was the belief that accounting students possessed a myopic view of their discipline which lacked grounding in, and was unrelated to, broader business, economic, and social phenomena. This belief prompted professional bodies to press educational institutions to include a wider range of both business-related and non-business courses in their curricula and to increase the attention paid to the development of students’ generic competencies [NZSA, 1984; AAA, 1986; AECC, 1990; ICAEW, 1993; JARTF, 1995; Paisey and Paisey, 2006]. From the perspective of accounting educators, the movement for accounting education change meant that “to foster lifelong learning, accounting teachers should focus on developing critical thinking skills, creating a climate of inquiry, encouraging divergent thinking, providing feedback, focusing on process not content, and designing evaluations that reflect higher order problem solving” [Doney et al., 1993, p. 297].

There is a body of work that spans many decades concerning the desirability of including accounting history in undergraduate and graduate programs in order to improve student learning experiences and learning outcomes. Zeff [1989, p. 204] suggested that “above all, a historical perspective is essential” in securing the essence of a liberal and broad-based education in accounting. In the mid-1980s, a committee of the American Accounting Association [AAA, 1986, p. 183] recommended that accounting programs include content concerning the “history of accounting and its role as an information system in society.” Other reports, such as those of the large public accounting firms [Arthur Andersen et al., 1989] and the Accounting Education Change Commission [AECC, 1990], also advocated that accounting programs feature the history of the accounting profession and the history of accounting thought [Coffman et al., 1993]. In light of such reports, and echoing Zeff [1989], Koeppen [1990,
pp. 89, 95] suggested that providing “students with a historical perspective of the events which have shaped the practice of accountancy” represents a major approach to educating, rather than merely training accountants, as well as inculcating an understanding and appreciation of “accounting culture.” Similarly, Flegm [1991, p. 355] held that teaching curricula should be broadened to include accounting history to enable students to evaluate and contribute to change in accounting practice. Other key academics have also pushed for accounting history to be taught as a regular component of accounting programs [Greenwood, 1997, p. 13].

More recently, the IFAC [2003, p. 46] promulgated *International Education Standards for Professional Accountants* which specifies that an accounting degree should include “history of the accountancy profession and accounting thought.” Many national accounting program accrediting bodies, such as those in the U.S., the U.K., Canada, and Australia, have an obligation as members of the IFAC to uphold and comply with these requirements [ICAA and CPA Australia, 2008, p. 3].

In relating accounting history to accounting practice in light of the fallout from the Enron collapse, Amernic and Craig [2004, p. 344] argued that:

> Current critics and commentators...are reminded that recent indictments of accounting, and some of the reforms suggested, are *déjà vu*, and have been ignored by accountants and accounting educators for decades. We cite some examples of these criticisms and invoke them as part of an appeal for greater regard to be accorded the study of accounting history.

The content knowledge and skills set developed or enhanced by studying accounting history has broad applicability and is eminently relevant within the climate of accounting education reform previously outlined, as well as in response to the concerns about accounting, audit, and corporate scandal identified by Amernic and Craig [2004; see also, Flesher, quoted in Hahn, 2006]. Accounting history education has the potential to improve students’ technical skills; appreciation of alternative theoretical perspectives, paradigms, and arguments; and understandings of the rationales, underpinnings, and evolution of historical and contemporary practices. Such study can build not only knowledge of accounting’s past, present, and future [Carnegie and Napier, 1996] and provide insight into the interplay of accounting with other discipline areas [Garner, 1974], but also
enhance students’ generic competencies in communicating, critical thinking, analysis, social and cultural awareness, and ethics [Koeppen, 1990; Ainsworth, 2001; Samson et al., 2006].

However, despite the professed benefits, calls to incorporate studies in accounting history into accounting programs do not seem to have generated significant developments in educational praxis in English-speaking nations, although accounting history education may have a higher profile in a number of European countries, such as Italy and Spain. Several research projects utilizing survey questionnaires have been conducted to elicit views on the need for accounting history education, particularly in the U.S., and have produced mixed results. A study conducted in the mid-1970s [WSUARS, 1978, p. 64] examined the perceptions of educators and public, corporate, and government practitioners (n=577), finding that these “accountants became more sensitive to the importance of accounting history as they reach senior levels in their careers” and “accounting educators expect accounting history to be significantly more important in ten years than it is today.” Several years later, a survey [Van Fleet and Wren, 1982, p. 112] of members (n=294) of the American Assembly of Collegiate Schools of Business (AACSB) and the Business History Conference revealed that while accounting, business, and/or economic history was included in the educational programs of an overwhelming number of respondent institutions, it was “usually taught as part of a course or courses rather than as one or more separate courses.” In a more contemporary survey, Slocum and Sriram [2001, p. 113] investigated academics’ (n=377) perceptions about whether calls for change in the accounting curriculum had been translated into additional “accounting courses with a predominant history content in U.S. business schools.” The researchers found that of 216 institutions, only two offered an accounting course with a history focus at the undergraduate level, 11 did so at the masters level, and seven at the doctoral level. The authors concluded that the number of accounting history courses had declined across the 1985 to 1997 period and that the results failed to indicate a commitment by institutions to implement the recommendations of the AECC and others active in promoting change in accounting education. Williams and Schwartz [2002] surveyed accounting faculty in AACSB-accredited schools (n=45), finding that, in general, faculty disagreed with the notion that undergraduate students should study a separate course in accounting history. While there was relatively weak agreement that accounting history should be part of the introductory financial accounting
course, respondents did not support the contentions that this would attract more business students to the accounting major, improve the relevance of accounting topics, or make learning accounting more interesting.

These diverse research results indicate significant differences between recommendations and forecasts concerning accounting history education compared to actual developments in educational practice over time. There is also scant extant literature that provides guidance for addressing the issue of how to incorporate study of accounting’s past into existing curricula, much less how to devise a dedicated accounting history course. Consequently, the main thrust of the current paper is to provide guidance in meeting these goals through the lens offered by discussion of a detailed and tangible illustration from practice.

There are several strategies with potential for bridging the divide between calls for accounting history education and action in implementing educational initiatives, with the most obvious being to feature aspects of accounting history in existing accounting courses at the undergraduate [University of Wyoming, 2005] and graduate levels. To an extent, this is already happening in many institutions internationally although in some it may well be that accounting history is dealt with “only by way of anecdotes” and as an “incidental” aspect of courses [Previts et al., 1990, p. 3]. However, several academics have published case studies on using particular historical accounting artifacts, books, or research publications as teaching and learning resources in introductory accounting, financial accounting, accounting theory, and auditing courses. Examples of these include utilization of:

- Pacioli’s treatise for informing classroom instruction [Sangster et al., 2007];
- account books from the 18th and 19th centuries for providing interdisciplinary instruction and aiding in the understanding of accounting concepts [Bloom and Solotko, 2005];
- historical annual reports in building technical skills and reinforcing the idea that “accounting evolves in response to environmental change” [Amernic and Elitzur, 1992, p. 29];
• histories of accounting firms to improve understanding of both subject matter and the history of the profession [Simon, 1995];
• medieval statements in revealing how accounting in any era is related to the social and economic institutions of the period [Piaker, 1972];
• historical and contemporary audits in teaching governmental accounting and the evolution of accounting thought [Ariail et al., 2008];
• adversarial roleplays based on Paton’s submission to a U.S. Wage Stabilization Board hearing as a basis for stimulating learning in accounting theory [Craig and Greinke, 1994]; and
• accounting history research articles, biographies, and videos in encouraging constructive thinking, conceptualization, and understanding of financial accounting and of the manner in which changing environments produce behavioral responses [Coffman et al., 1993; Previts et al., 2006].

Nevertheless, these examples may be exceptional within the wider sweep of accounting education since, as Simon [1995, p. 1] notes, “in most curricula, little or no attention is paid to history in financial accounting, cost accounting, or auditing classes.” Further, in discussing the incorporation of accounting history into other accounting courses, Deinzer [1965, p. 1] drew a Gestaltian conclusion in warning that “the characteristics of a whole may not be shared by parts of the whole.”

In addressing Deinzer’s [1965] cautionary note, another course of action is to pursue, with renewed vigor, the inclusion of a dedicated accounting history course in undergraduate programs [Napier, 1983; Greenwood, 1997]. While Albrecht and Sack [2000, pp. 46-47] concluded that accounting history featured among the courses which had been added to curricula in U.S. universities across the period from 1990 to 2000, and thus some change appears to have occurred, the inclusion of such courses is problematic due to long-held concerns that the curriculum in bachelor degree programs is already overcrowded [e.g., Peragallo, 1974; Mathews, 1991; Williams and Schwartz, 2002]. Interestingly, Albrecht and Sack [2000, p. 46] classified accounting history courses as “content-type adding,” as opposed to “broadening type [skills development] adding,” which is at odds with the views of a number of commentators on the role of accounting history in the curriculum in providing a broader educational perspective and enhancement of students’ generic competencies.
A further alternative is to include studies of accounting history as part of the doctoral degree [Fleischman et al., 2003; Flesher, 2004]. Despite Homburger’s [1958, p. 503] observation of half a century ago that in the U.S., “the course in accounting history is now fairly well established as an essential part of the graduate curriculum in accounting,” later commentators have suggested a paucity of attention to such studies in American doctoral programs [Previts et al., 1990, p. 3]. While the study of an accounting history course is possible to the extent that doctoral programs, particularly those in the U.S., have a seminar or course-work component, many British, mainland European, and Australian doctoral programs are by thesis only and do not include course work. As a result, attempts to generate interest in accounting history and encourage accounting history research may be foregone if not considered at an earlier stage. Consequently, another suggestion is to include accounting history as a course-work offering at the honors level [Forrester, 1976; Boys, 1980; University of Glasgow, 2007; University of Strathclyde, 2007; Victoria University of Wellington, 2007]. Finally, there is the option of a masters-level course in accounting history, an approach to the implementation of this strategy that is described in depth in the succeeding section of this paper.

MODELING A COURSE IN ACCOUNTING HISTORY

The current section describes and models the development of an accounting history course offered by an Australian university. The course, ACC536 Accounting and Business History, was launched in 2008 as a major new elective in the Master of Commerce Accounting (MCom(Acc)) degree program at Charles Sturt University (CSU). The degree serves a niche market of accounting graduates who are generally working full-time and opt to study on a part-time basis via distance education. CSU “was the first university in Australia to develop courses specifically with distance delivery in mind” [CSU, 2008] and has around 40,000 students, of which more than half study via distance mode [CSU, 2006]. The University’s MCom(Acc) program has been offered since the mid-1990s and can be completed by course work or course work with dissertation. The overall degree program is focused particularly on the theory-research-practice interface with an assessment regime that is largely unique for each student, emphasizing reflective and authentic learning activities within a student-centered, constructivist learning paradigm. The program has proven to be of increasing popularity.
not only with accounting practitioners, but also with accounting academics. Over 15% of graduates from the program have gone on to undertake doctoral studies in accounting.

Unlike most MBA programs, the CSU MCom(Acc) is classified as a specialist masters degree by the largest of the Australian professional accounting bodies [CPA Australia, 2007]. A competitive analysis revealed that ten2 of Australia’s 39 public and private universities offered a specialist masters as an add-on degree for accounting graduates which was genuinely equivalent to the CSU MCom(Acc). However, an examination of the courses within these programs showed that none of the institutions were currently offering a dedicated accounting history course. Similarly, searches conducted via the world-wide web failed to yield sufficiently detailed data on similar graduate courses offered by institutions overseas [e.g., the critical accounting history course, “Accounting Classics,” of the University of Strathclyde, 2007].

The initial development of the CSU Accounting and Business History course was based on the competitive analysis described above, a needs assessment involving consultation with past and current students in the MCom(Acc) program, consideration and review by course advisory panels, and the application of techniques and standards in curriculum mapping and instructional design. Such techniques had been successfully applied in the conceptualization and creation of other courses in the program in the past [Bisman, 2005, 2006, 2007c, 2007d]. Collectively, these development procedures resulted in support for a course in accounting history; the identification of a range of potential topics and approaches to the construction of the course materials; and rationales for determining the final orientation, content, and assessment regime to be adopted.

Course Orientation: The central tenet of the Accounting and Business History course is to present the area of accounting history as embedded within salient business, institutional, economic, social, and political contexts, recognizing the relationships of accounting and business history [see Fridenson, 2007] within a

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2At the time the competitive analysis was conducted (2006 to 2007), publicly available information was obtained from university websites, university handbooks/calendars, and CPA Australia [2007], resulting in the identification of the following Australian universities that were offering, or had recently offered, a genuinely similar degree program: Curtin University of Technology, Griffith University, Macquarie University, Monash University, University of Adelaide, University of Melbourne, University of New England, University of Sydney, University of Western Sydney, and University of Wollongong.
framework to which accountants could readily relate and that would be relevant to their current professional practice. In discussing the study of accounting history, Homburger [1958, pp. 501-502] claimed that:

To have meaning and purpose...the history course must be much more than a study of historical data. Even a mere comparison of past and present practices will not do. In approach and content the course must be designed to evaluate critically, by way of comparison, past and present theories and procedures in the light of the requirements set by the social and economic conditions of each period and each country. The primary objective of this approach must be the improvement of the professional competence and judgment of the modern accountant.

In line with this perspective, the idea of the ACC536 course was not to present a doctrinaire overview of the past, but rather to show how accounting history has shaped current accounting practice and to provide students with the knowledge and skills needed for making informed decisions about innovations and changes in practice. Thus, the course materials supplied to students specifically stress that such objectives are “primarily achieved through guiding you to the conclusion that accounting history is relevant to the real world today and that we can actually use knowledge of accounting history in better understanding, evaluating, criticising and improving modern accounting practice and policy” [Bisman, 2007b, p. 5]. Commencing from the position that accounting history is a pervasive force in contemporary accounting practice, the course materials make several points to illustrate how accounting history permeates the world of the modern accounting professional. For example, drawing insights from Parker [2001], the materials describe how most financial newspaper reports and journal articles in professional accounting magazines and the scholarly literature, as well as accounting standards and other technical and policy publications, regulations, and legislation, begin with a sketch of the background to an issue, providing a necessary historical context to underpin the discussion. Following Lee’s [1990] systematic outlook on the history of the domain of accounting, the introductory materials [Bisman, 2007b, p. 6] also make the point that:

In our professional lives as accountants our own history of personal experiences guides the way we behave, how
we make decisions and how we carry out our work. The history of the organisations in which we work determines how those organisations function, the procedures adopted by the organisations, and how those organisations react to change. More broadly, the economic, social, political and cultural histories of the nations in which we live, and the governments which guide and oversee those nations, give rise to how communities, societies, and nations as a whole go about business and interact with one another.

In determining the content of the course, due recognition was given to Parker’s [1993, p. 106] contention that “accounting history is increasingly dominated by writers in English discussing private sector accounting in English-speaking countries of the nineteenth and twentieth centuries,” as well as Carmona’s [2004] findings which support this argument [see also, Walker, 2005]. By way of contrast, the course [Bisman, 2007b, pp. 19-20] is presented as an inclusive, international sub-discipline area of accounting, featuring:

- a focus not only on accounting history in English-speaking nations and westernised cultures, but also on accounting in other nations, civilisations and cultures;
- an examination of the roles of gender, race, and religion in accounting history;
- a consideration of history from ancient times through various historical eras, rather than solely concentrated on developments in accounting which occurred in the 19th and 20th centuries; and
- accounting history as it relates to the public sector as well as the private sector.

Course Structure, Delivery, and Content: Since the Accounting and Business History course is offered only by distance education, teaching delivery is via print-based course materials, supported by a range of online facilities and technology-mediated contact with teaching staff. The printed course materials consist of three components. The first component is a 20+ page “Subject Outline” which gives an introduction to the course and provides descriptions of teaching strategies, learning support, and administrative procedures. A 146-page “Study Guide,” detailed later in this section of the paper, facilitates students’ learning. A range of essential readings comprise the third component of the course materials. The online environment provides students with elec-
tronic versions of the “Subject Outline” and “Study Guide,” an online discussion forum and news board, and an electronic assessment submission facility, among other capabilities.

The course learning objectives [Bisman, 2007b, p. 3], appearing in the “Subject Outline,” highlight that upon successful completion of the course, students should be able to:

- outline the nature of historiography and the range of research methods relevant to historical study in accounting and business;
- enumerate and discuss differences between ‘old’ and ‘new’ accounting histories;
- chart the major developments in accounting thought and practice from ancient to contemporary times;
- demonstrate the essential skills to undertake and critically evaluate historical research in accounting and business; [and]
- discuss the relevance of, and apply historical findings to, modern accounting practice.

From these overall learning objectives, together with due consideration of the content of the eight topics in the course, a set of specific, task-oriented learning objectives for each topic is provided in the “Study Guide” as a means to delineate and formalize the nature of expected learning outcomes. The “Study Guide” also contains an extensive Commentary section written by the teaching convenor which discusses the context and content of each topic, highlights key issues, and provides further insights and information on the more problematic, controversial, or unusual aspects of particular topics. The Commentary also demonstrates how individual aspects of a topic, and different topics, fit together. The Commentary is designed to be used by students on an interactive basis and functions to facilitate and scaffold their learning, introducing the topic and including discussion interspersed with activities. Usually the first activity embedded within the Commentary will be a requirement for the student to read a particular paper provided in the study package. To encourage active reading, the next activity presented is generally a Study Task or Reflective Activity (several of which constitute the formal assessment items) requiring the student to construct and argue a case (see Appendix A).

The essential readings for the course are a diverse set derived from major journals which publish research on accounting’s past, together with selected chapters from relevant books. Examples of readings in the course appear in the following citations. The initial readings concern the study of history
in general [Tosh, 2006] and the study of accounting history and historiography [Previts et al., 1990; Fleischman et al., 1996; Williams, 1999; Napier, 2001]. Other readings examine accountants, the profession, and professional bodies [Brown, 1905; Linn, 1996; Parker, 2005], and accounting in governments and public and private-sector organizations [Chatfield, 1968; Oldroyd, 1997; Nikitin, 2001; Anes, 2002; Jurado-Sánchez, 2002; Abeysekera, 2005; Carmona and Ezzamel, 2007]. The historical (and contemporary) relationships, influences, and interplay of accounting in respect to religion [Zaid, 2004]; gender, ethnicity, and culture [McKinnon, 1994; Hammond, 2003; Annisette, 2006]; and trade, business, and commerce are also represented [Brown and Johnston, 1963; Hale, 1978; Fleischman and Parker, 1992; Parker and Lewis, 1995; Flesher et al., 2003; Mussari and Mussari 2006]. Operating within the confines a single semester offering, it is not possible to do more than overview numerous of these areas; however, the readings, learning activities, and formal assessments provide the scope to illustrate the relevance of accounting’s past to the domain of the modern accounting profession. Further, the course goes beyond presenting a sterile and passive retrospective on accounting by challenging conceptions through the inclusion of confronting examples of accounting practices, such as accounting for slaves and reflections on the morality of these practices, introducing elements of critical pedagogy to the curriculum [Barney and Flesher, 1994; Fleischman et al., 2004; Fleischman, 2004; Tyson et al., 2004, 2005]. Students are also introduced to debate in the field, including the divide between “old” and “new” schools of thought on accounting historiography [Carnegie and Napier, 1996; Funnell, 1996; Fleischman, 2004], and alternative views on the interpretation and use of archival materials in accounting history research [e.g., McDonald, 2005, 2006; Hooper, 2006]. Examples are provided in the readings and “Study Guide” Commentary of works representing the areas of biography; micro-history; prosopography and institutional histories; social, political, and economic history; and critical histories, consistent with the goal of providing an holistic overview of topics in, and approaches to, accounting history.

The topics in the course could have been sequenced thematically, by sub-discipline area, or according to geopolitical attributes; however, a chronological order was chosen as providing the most appropriate means to illustrate development and change in accounting over time and, in some cases, to demonstrate stagnation in accounting innovation, the recursive
nature of particular techniques, or the reoccurrence of issues and events. The latter two points reflect Sterling’s contention that “accountants...don’t solve problems; we recycle them” [Sterling, quoted in Rutherford et al., 2001]. This structure also demonstrates to students how accounting is embedded within the broader social, political, and economic environments peculiar to specific eras. While each topic is presented as a separate and largely self-contained examination of accounting and business history within a particular epoch, links between crises and events across periods and the flow-through of techniques from one era to another are discussed in the readings and Commentary. The basic structure of the course is modeled in Figure 1.
As shown in Figure 1, the first topic in the course outlines fundamental considerations in history, historiography, and historical methods, emphasizing the importance of context in historical analysis and interpretation and introducing the role of accounting history in accounting education. This topic gives an overview of history as a disciplinary area of study and is designed to provide basic knowledge and skills, as well as supplying an architecture for the subsequent examination of specific topics in accounting history. In Topic 2, these themes are more closely aligned with accounting, including a survey of the philosophy, traditions and methods of analysis, and writing in accounting history. The third topic explores the rise of civilizations and governments, notions of quantification and counting, and the development of accounting practices in the ancient world. Topic 4 overviews accounting procedures in classical antiquity, arising from the advent of money in ancient Greece and the military machine and framework of laws and taxes developed within the Roman Empire. Topic 5, covering the Middle Ages, focuses on manorial and “feudal” accounting in medieval Europe, although two of the six readings for this topic concern accounting practices of the period in other places and cultures. The next topic examines accounting in the Renaissance, focusing particularly on the rise of double-entry bookkeeping. Topics 7 and 8 are the largest, principally because of the range and pace of accounting developments occurring during the Industrial Revolution through the early 21st century. The choice of themes to include in the final topic was particularly difficult. Among potential themes were accounting harmonization, social and environmental accounting, accounting and computerization, strategic management accounting, auditor independence, accounting ethics, and accounting and public-sector reform. However, none of these issues became particular features of the final topic in the course, in part because many of them are covered in other courses in the masters program. The themes ultimately selected were the development of professional accounting bodies and accounting standards, histories of corporate collapse and audit failure, and the influence of the scientific management movement on cost and management accounting. The final topic also provides observations on the recurrent nature of many of the challenges faced by the profession.

Historical Reasoning, Generic Skills, and Course Assessment: The student self-study activities and compulsory assessment items (samples of which are presented in the appendix) encompass
each aspect of van Drie and van Boxtel's [2008] framework for analyzing students’ historical reasoning as a means for informing educational practice (Figure 2). The authors note that, as distinct from mere historical literacy or historical consciousness, “historical reasoning emphasizes the activity of students and the fact that when learning history, students acquire not only knowledge of the past, but also use this knowledge for interpreting phenomena from the past and present” [van Drie and van Boxtel, 2008, p. 88, emphasis added]. Within the accounting history course, such reasoning, and the demonstration of that reasoning through the completion of study activities and formal assessments, also provides students with experience in applying and further developing a range of generic skills. The Study Tasks in the course focus on knowledge synthesis and critical evaluation, while Reflective Activities are more personalized, requiring students to reflect on practice and draw on their own prior learning and professional experiences. Since several of the Study Tasks and Reflective Activities ask for students’ ideas about parallels or distinctions between historical accounting practices and those of the modern day, students are also encouraged to source and use contemporary references when framing arguments.

**FIGURE 2**

Components of Historical Reasoning

Source: van Drie and van Boxtel, 2008, p. 90

In “asking historical questions,” as depicted in the model presented in Figure 2, the research [van Drie et al., 2006]
suggests that evaluative rather than explanatory questioning improves historical reasoning and argument. Explanatory questioning requires students to offer an explanation as to why something occurred and can often result in students regurgitating the findings of the existing literature and proffering the arguments and opinions of others in providing that explication. Conversely, asking evaluative questions engages students in original thought, challenging them to develop their own commentary, assessment, opinions, and critical reflections, and, hence, to construct personalized meanings and understandings of phenomena. Reflective Activities 3.1, 6.2, and 6.5 (see Appendix A) are examples of evaluative questions used in the ACC536 course. In terms of the “use of sources” (Figure 2), Reflective Activity 3.3 and Study Task 5.3 (see Appendix A) require students to evaluate primary and secondary sources and assess the use made of those sources by established accounting historians. “Contextualization” is a particularly important concept stressed throughout the course. Learning exercises, such as Reflective Activity 4.4 and Study Task 7.4 (see Appendix A), engage students in considering historical contexts. “Argumentation” features in almost all of the Reflective Activities since these activities elicit reasoned opinions from students, such as in responding to Reflective Activities 2.1 and 8.7 (see Appendix A). “Use of substantive concepts” refers to “historical phenomena, structures, persons and periods” [van Drie and van Boxtel, 2008, pp. 99, 101], while “use of meta-concepts” relates to “the methods used by historians to investigate and describe historical processes and periods.” Substantive concepts are explained throughout the course “Study Guide.” For example, in the Commentary for Topic 5, the period constituting the early Middle Ages is defined and described as a prelude to the first required reading for the topic – Oldroyd’s [1997] discussion of accounting in Anglo-Saxon England. “Using meta-concepts” includes the application of heuristics which relate to describing processes of historical change, comparing and explaining historical phenomena [van Drie and van Boxtel, 2008, p. 103]. Opportunities for students to use meta-concepts feature significantly in many of the learning tasks, with some specific examples being Study Tasks 5.1 and 6.5 (see Appendix A).

In addition to developing these historical reasoning abilities, students are explicitly informed that the course work and assessments necessitate the further development and demonstration of key generic and meta-cognitive skills in research, analysis, critical thinking, academic writing, and reflective learning [Bisman, 2007a]. One of the introductory readings on the nature
of history allows students to relate the skills honed by studying history to the key generic competencies expected of accountants by employers and the professional bodies. The reading rallies a number of arguments [Stearns, 1998, p. 2] in making a case that studying history helps to:

create good business people [and] professionals...[with] a broad perspective that gives them the range and flexibility required in many work situations. They develop research skills, the ability to find and evaluate sources of information, and the means to identify and evaluate diverse interpretations. Work in history also improves basic writing and speaking skills and is directly relevant to many of the analytical requirements in the public and private sectors, where the capacity to identify, assess, and explain trends is essential...history particularly prepares students for the long haul in their careers, its qualities helping adaptation and advancement beyond entry-level employment.

Both the mandatory assessment and self-study activities are constructively aligned [Biggs, 2003] with the learning objectives, topic content, and generic attributes assigned for the course. In the formal assessments, students complete a total of 12 learning activities, consisting of four set items in each assessment derived from the Study Tasks and Reflective Activities presented in the course materials. The remaining two items in each assessment allow students to choose a further Study Task and an additional Reflective Activity of particular interest to them. Collectively, the course materials include around 70 Study Tasks and Reflective Activities developed and written specifically for this course, giving students ample scope in determining the self-selected components of their assessments. The first assessment covers Topics 1 to 5 in the course, and the second assessment covers the remaining three topics. Examples of assessable Study Tasks (3.1 and 7.6) are provided in Appendix A.

CONCLUDING COMMENTS

This paper presents a case for accounting history studies to be recognized as an essential and valuable ingredient of accounting education programs, with the intention of producing more competent and informed professional practitioners and, through stimulating an interest in accounting history, engendering the development of the next generation of accounting historians. By detailing the development process, learning objectives,
orientation, content, and other elements of a recently created graduate course in accounting history offered by an Australian university, the course model supplies a tentative blueprint for designing similar courses in other contexts or countries.

While slavish adoption of the course model is certainly not suggested since it can be expected that each educator would structure the course according to his/her own background, experience, and epistemic preferences, the model does provide suggestions for educators in thinking about topics, content, sequencing, the role of readings, and the types and function of assessment in such a course. For example, within the U.S. graduate school setting, there is an array of masters programs in accounting offered via distance education and online, so that suggestions concerning the student-centered approach to structuring materials and assessment in the course may be of particular benefit in these settings. However, given that numerous U.S. masters programs are structured to provide the knowledge and skills necessary for successful completion of the CPA Examination, while the Australian course modeled in this paper assumes that students have already completed relevant professional exams, the placement of such a course within particular U.S. programs may be better suited to the doctoral seminar.

One pressing problem encountered in including accounting history in the curriculum is that few universities in Australia, the U.S., or elsewhere have accounting staff interested or experienced in teaching an accounting history course. In their study of accounting and business history in U.S. business programs, Van Fleet and Wren [1982, p. 114] reported the comment that “how much history gets into classes is strictly a function of the instructor’s knowledge and interest,” while Merino [2006, pp. 377-378] contends that most younger faculty “have not been exposed to economic history, much less accounting history.” Consequently, creating new generations of accounting historians is important not only for maintaining an active accounting history community and the continued production and dissemination of historical accounting research, but is also vital in ensuring accounting history is taught within accounting programs in the future. The linking of the research and education aspects is imperative since, as Richardson [2008, p. 269] submits, “the development of accounting history courses and graduate research programs will be the next test of the disciplinary strength of accounting history.” Thus, in addition to inspiring thought (and debate) on accounting history education, the current paper also represents a call to action for accounting history researchers to
lobby for and engage in the development of courses in the study of accounting's past for inclusion in the programs offered by their own universities.

The description and discussion of the course also addresses a lacuna in the existing accounting history and accounting education literatures which provide relatively few examples of accounting history education in practice. There is, however, significant work still to be done with respect to accounting history education. Suggestions for further work include the conduct of attitudinal surveys about accounting history education in Australia and other nations to supplement and compare with the existing U.S. research findings. Also needed is publication of descriptions of dedicated accounting history courses offered at universities since the apparent absence of such literature suggests these courses are largely undocumented at present. In discussing business history education, Harvey and Wilson [2007, p. 3] contend that it may well be taught “by stealth...under the rubric of more contemporary sounding subjects.” Consequently, additional vignettes of accounting history included as part of other accounting courses are also desirable in generating interest and informing teaching practice. An expanded range of articles on accounting history education appearing in the mainstream accounting education literature, as well as in the specialist accounting history journals, is also warranted.

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APPENDIX A
EXAMPLES OF STUDY TASKS AND REFLECTIVE ACTIVITIES

Reflective Activity 2.1: In your opinion, is accounting evolutionary? Are there merely some aspects of accounting that evolve, while other aspects change or develop in a non-evolutionary manner? Do you think there might be differences between accounting ‘evolution’ and accounting ‘progress’? (Activity relates to the reading by Napier, 2001).

Reflective Activity 3.1: In their conclusion, Carmona and Ezazzmel [2007, p. 202] state: ‘even today, there is still a perception that ancient accounting (if it is considered accounting at all) is far too remote to be worth taking seriously’. How do you feel about the nature and worth of ancient accounting history?

Reflective Activity 3.3: How convincing did you find the case advanced by Lu and Aiken [2004] concerning the links between the early Chinese writing system, counting, and accounting?

Reflective Activity 4.4: How important do you think context was in the nature and uses made of the early Australian censuses and musters? (Activity relates to the reading by Bisman [forthcoming, 2009]).

Reflective Activity 6.2: To engage in this activity you will need to refer back to Zaid [2004] on Islamic accounting systems of the Middle Ages and also note the quotation towards the start of the Commentary for Topic 6 which concerns the business dealings of Venetian merchants with Arab merchants during the Renaissance. Zaid [2004, p. 168] says: ‘It is apparent that some of the recording procedures developed and practiced in Muslim society were similar to those which were later [emphasis added] applied in medieval Europe. Indeed, Ball [1960] stated “we can hardly suppose that the Italian merchants were ignorant of the methods of keeping accounts used by their best customers”’. Napier [2007],
in discussing the role of Islamic accounting, states that it has been one of the most significant influences on accounting in the Western world for many centuries and expresses concern that: ‘suggestions that accounting methods in Islamic societies were influences on the emergence and development of double-entry bookkeeping have been resisted’. Given your understanding of the interplay between commerce, social relations, religion, and the spread of particular accounting techniques from one civilization or geographic locale to another, together with your understanding of Pacioli’s work and life, what is your opinion on where the double-entry bookkeeping system developed and who developed it?

**Reflective Activity 6.5:** What do you think about the idea of the ‘archaeological accountant’ which is a notion underlying the architectural analysis supplied in Mussari and Mussari [2006]? Can you see any similarities in the ideas of an ‘archaeological accountant’ with the modern day role of the forensic accountant?

**Reflective Activity 8.7:** What aspects of ACC536 interested you the most? Why? What aspects interested you the least? Why? Briefly describe:

(a) three accounting issues, events, crises, procedures or practices covered in your study of ACC536 Accounting and Business History that have had the most impact for you in terms of the way you think about accounting; and

(b) three accounting issues, events, crises, procedures or practices covered in your study of ACC536 Accounting and Business History that have the most impact for you in terms of the way you practice accounting.

**Study Task 3.1:** ‘The life of a scribe was, according to this Satire of the Trades, a pleasant existence. He has power over everyone. His ability to read and write is more valuable than food, drink, clothes or ointment, even a tomb for the afterlife. If a scribe joined the civil service [government/public sector], it was claimed, he did not have to pay taxes’ [Hayes, 1997, p. 53]. Using the quote above from Hayes [1997] which concerns the power, class and value of ancient Egyptian scribes, together with the information on record-keeping and scribes presented in Brown [1905], compare and contrast the role and status of the scribe with that of the modern-day accountant.
Study Task 5.1: At the end of Reading 5.1, Oldroyd [1997] claims: ‘Evidence of accounting exists in the surviving documentation, in the sophistication of government finances, in the Anglo-Saxon mind-set relating to the use of money and monetary values, and in the continuity between earlier and later periods...’ What are the “continuities between “earlier and later periods” identified in this reading? Compare and contrast the use of money and monetary values in Anglo-Saxon England with that of Classical Antiquity (Topic 4). Compare and contrast the role of government finance and accounting in Anglo-Saxon England with government finance and accounting in both ancient times (Topic 3) and Classical Antiquity (Topic 4).

Study Task 5.3: Based on McDonald [2005], Hooper’s [2006] criticisms of the efficiency calculations made by McDonald, and McDonald’s [2006] response, with whom do you agree and why?

Study Task 6.5: On the basis of Reading 6.4 [Mussari and Mussari, 2006] construct a table which identifies the various personnel and their roles in the accounting systems used at the building yard of the Castello of Crotone during the Renaissance. Compare these roles with modern day specialisations in accounting and business.

Study Task 7.4: In what ways did the political, economic and legal systems and the social context of Meiji era Japan influence accounting for both internal management purposes and external reporting? (Task relates to the reading by McKinnon, 1994).

Study Task 7.6: In Fleischman et al. [2004, p. 41] the authors explain a procedure that was used in accounting for increases and decreases in the number of slaves and elaborate on aspects of this system at later stages in the paper. Compare and contrast this accounting procedure with the procedures used in accounting for livestock, as detailed in relevant readings in ACC536, during ancient times (Topic 3), in the Middle Ages in Britain (Topic 5), and in medieval Islamic societies [see Zaid, 2004].
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