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The Accounting Historians Journal

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Fall 1983
Volume 10, Number 2

Research on the Evolution of
Accounting Thought and
Accounting Practice

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Semiannual Publication of The Academy of Accounting Historians

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Manuscripts must be in English and of acceptable style and organization for clarity of presentation. Submit three copies typewritten, double-spaced (except for indented quotations) on one side of 8½ x 11 inch (approx. 28.5 cm x 28.0 cm) white paper; paragraphs should be indented. An **abstract** of not more than 100 words should accompany the manuscript on a separate page. The manuscript should not exceed 7,000 words and margins should be wide enough to facilitate editing and duplication. All pages, including footnote and bibliography pages, should be serially numbered.

The cover sheet should state the title of paper, name(s) of author(s), affiliation, and the appropriate address for further correspondence. The title, but not the name(s) of the author(s), should appear on the abstract page and on the first page of the body of the manuscript. Acknowledgments should appear at the bottom of the first page of the body of the manuscript and be excluded from the consecutively numbered footnotes.

Manuscripts currently under review by other publications should not be submitted.

Major headings within the manuscript should be centered, underscored, and unnumbered with the first letter of major words capitalized. Subheadings should be on a separate line beginning flush with the left margin, and underscored with the first letter of major words capitalized. Third-level headings should lead into the paragraph, be underscored, and followed by a period; text should immediately follow on the same line.

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When referring to statutes, court cases, or legal treatises, citations acceptable in law reviews should be used.

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FOOTNOTES

[1] Chatfield, p. 52.
[2] Previts (1982a), p. 8.
[3] Previts (1982b), pp. 19-20.

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Previts, Gary John. "Hazy History: Fact and Folklore in Accounting." *The Accounting Historians Journal,* Vol. 9, No. 2 (Fall 1982a), pp. 7-9.

————————. "Old Wine and . . . the New Harvard Bottle." *The Accounting Historians Journal,* Vol. 9, No. 2 (Fall 1982b), pp. 19-25.

As a helpful guide to questions of style not covered above, refer to *A Manual for Writers of Term Papers, Theses, and Dissertations* by Kate L. Turabian, published in paperback by The University of Chicago Press.

Galley proofs will be sent to the author(s) as permitted by scheduling; however, additions of new material must be strictly limited. The author(s) will be provided five copies of *The Journal* issue in which the manuscript is published.

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Editorial

Since this is the last issue of the *Journal* for which I have responsibilities as Manuscripts Editor, I would like to reflect on several aspects of the *Journal* during my term as a member of the Editorial Staff.

My approach to the responsibilities of the Manuscripts Editor appears to have been similar to that of my predecessor. After receiving a manuscript for possible publication, I forwarded it to two selected members of the Editorial Board for blind reviews. Based on their recommendations, the manuscript was accepted, not accepted, or returned to the author for revision. In cases where the reviews of the manuscript resulted in one acceptance and one rejection, the manuscript was forwarded to another member of the Editorial Board. *Ad hoc* reviewers were occasionally used when it was thought to be in the best interest of the author. While the Manuscripts Editor has the final say as to whether or not a manuscript is published, my policy was to rely on the recommendations of the reviewers. In each instance I was most pleased with their comprehensive reviews, and I never felt it was necessary to alter their recommendations. Regardless of the decision concerning a manuscript, comments of the anonymous reviewers were provided to the author. As Manuscripts Editor, I felt it was not only my responsibility to edit the manuscripts, but also to edit the other material in the *Journal.*

The established format of the *Journal* was basically maintained with separate sections for Feature Articles, Historical Nuggets, Book Reviews, and Doctoral Research; however, some changes were made to streamline the presentation. Information about the Editorial Staff was moved from the inside front cover to later pages of the *Journal*, and information on The Academy of Accounting Historians was put on this inside cover. Both the Guide for Submitting Manuscripts and the Reproduction Policy were revised. The *Journal* was expanded to approximately 150 pages per issue. Attempts were made to maintain the international scope of the *Journal*, as well as to continue to have a balanced composition of articles on the various areas of accounting history.

A major accomplishment during my term as Manuscripts Editor was co-editing and codifying the first three years of *The Accounting Historian* (forerunner of the *Journal*) into one bound volume similar in size and format to that of the *Journal.* This volume and Volumes

4 through 10 of the *Journal* provide a complete set of those research materials that have been published by the Academy to date. In a related matter, the Production Editor, Merv Wingfield, and I are in the final stages of completing a 10-year index of authors and subject matter for the *Journal*.

My sincere appreciation to everyone who has served on the staff of the *Journal* during my three-and-a-half year term, particularly to Mervyn W. Wingfield, Production Editor; Gary John Previts and Williard E. Stone, Advisory Editors; Dale A. Buckmaster, Book Review Editor; and Maureen H. Berry, Doctoral Research Editor. My very special thanks, of course, to all the members of the Editorial Board whose competent help made my task much less demanding. It is a necessity to have a sincere and dedicated editorial staff to produce a major journal, and I was most fortunate to have worked with such a staff.

I view my term as Manuscripts Editor as one of enhancing the internal operations of the *Journal*, streamlining its presentation, and maintaining the quality of its contents. It was a pleasure to have served as Manuscripts Editor, and I hope that my efforts have contributed to the continued development of the *Journal*.

Edward N. Coffman
Manuscripts Editor

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John K. Courtis
UNIVERSITY OF WATERLOO

BUSINESS GOODWILL: CONCEPTUAL CLARIFICATION VIA ACCOUNTING, LEGAL AND ETYMOLOGICAL PERSPECTIVES

Abstract: Confusion as to the real nature of commercial goodwill is well-entrenched in the literature, as evidenced by accountants' attention to valuation formulae rather than the underlying assets. The paper traces conceptual clarification of business goodwill via early writers on accounting, legal opinion and etymology. These three perspectives, together with a chronology of 91 selective definitions, reveal the shift in thinking over the past century. Goodwill, from being thought of as a set of inducements which attract persistent patronage, has become submerged by methods of valuation based upon superior earning power concepts and by the accounting notion of a residuum.

Introduction

The purpose of the paper is to illustrate how early writers on accounting, legal opinion associated with selected English case law, and etymology have contributed towards conceptual clarification of the nature of business goodwill. Many descriptions and definitions of goodwill have been presented over the past century by accountants, businessmen, judges, lawyers, economists and others; a selective and comprehensive chronology of these appear in Appendix I. Most of these quasi-definitions can be criticized for being insubstantial, too general, and especially for confusing the nature of the concept with a technique for ascertaining its value. Goodwill has been described as an impalpable,[1] ethereal,[2] incorporeal,[3] ephemeral,[4] immaterial, abstract, shadowy and intangible asset, while it has been defined in such vague terms as advantages, benefits, factors, rights, sources and privileges possessed by a successful business. Through this diversity, a body of definitions has accumulated which are couched in legal, pragmatic, residual, facetious, and philosophical terms.

The scope of the accounting literature survey was determined by the list of references to "goodwill" in the original *Accountants' Index*, published in 1921, together with twenty-six succeeding supplements. The bibliography cites all those references which were accessible to and considered by the author. The legal survey is unavoidably brief, restricted essentially to early English case law, especially those cases often cited as shaping the later thinking of the Courts in legal decisions dealing with purchased commercial goodwill. Appendix II, however, lists 17 statutes and 120 British and American cases which have had a bearing on the protection of legal goodwill. The etymological survey traces the meaning of the words "good" and "will" through 280 separate references in the complete *Oxford English Dictionary.*

The most noteworthy literature expositions on the nature of goodwill appeared during the latter part of the last century and the first half of this century. Emphasis is placed, therefore, on the evolution of the nature of goodwill by relevant authors during this period. Modern textbooks unfortunately are essentially irrelevant for this purpose because their pragmatic orientation de-emphasizes in-depth discussion at the conceptual level in favour of the methods of measurement and amortization.

Evolution of Accounting Thought

Before the growth of the number of joint stock companies, sole proprietors and partnerships represented the common form of business organization. During this time, essentially before the turn of the century, goodwill was more of a personal nature, attaching to the business because of personality, fairness, and skill of the proprietor or partners. Goodwill became of commercial interest when a business was sold or upon the death of a partner. Because professional accounting societies were only in their formative stages at this time, fragmented opinion existed as to the presence and nature of goodwill, and early accounting writers necessarily relied upon their own experiences and legal opinion emanating from early English case law for guidance.

The earliest detected reference in the accounting literature dealing with the nature of goodwill appeared in 1882 in Bithell's *A Counting House Dictionary.* There he described it as:

> The advantage connected with an established business of good repute. A well-established business presents an expectation of profits to any one entering upon it, and is worth paying for. Anyone having such a business and who is willing to relinquish the expectation of the business by transferring it for consideration to someone else can do so

> by what is technically called "selling the Goodwill of that business."[5]

This definition (such as it is) contains the two elements that have generated perpetual muddle. On the one hand, Bithell refers to goodwill as "the advantage," while on the other hand, he implies that a relationship exists between advantage and "expectation of profits." During the next fifteen years accounting writers such as Harris, Moore, and Whatley discussed goodwill within the context of methods of valuation (essentially based upon profits), while Bourne, Roby, and Warren (see Appendix I) expand the notion of "advantage" into a list of business attributes that establish habitual patronage of the public. Continuously throughout the chronology of definitions there is this slippage in thinking between goodwill as attributes that generate patronage, and goodwill as an asset resulting from application of a profit capitalization formula.

Professor L. R. Dicksee, author of *Goodwill and Its Treatment in Accounts,* the first book devoted entirely to the subject of goodwill and published in 1897, stated that:

> The favourite definition [of goodwill] is "the benefit arising from connection and reputation, the probability of old customers going to the new firm which has acquired the business," but one of the best which I have been able to discover is "the value of that reputation which a business has acquired during its continuance, which induces the confidence or expectation that the same, or an increasing, patronage will continue to be expected so long as the business is conducted in the same place upon the same principles."[6]

One year later, Edwin Guthrie read a comprehensive paper on the subject of goodwill to the Chartered Accountants' Students' Society of London. In elaborating on the nature of the concept he stated that:

> [Goodwill] differs from other property, inasmuch, as, while other property is palpable, goodwill is impalpable. Other property can be handled, weighed, or measured, its nature ascertained by inspection, its quality tested by sight, smell, feeling, or analysis, or the annual income receivable from it identified. But goodwill—how can its quality be ascertained? The difference between the two kinds of property is like that between matter and life, or between a man's

> estate and a man's character—one is ponderable, the other imponderable.
>
> The term goodwill is a very natural one and I think indicates what is meant better than any other word would do. It represents the goodwill with which the person, the place, the name, or the association is regarded. It assures the direction of the footsteps of customers towards the customary place—that involuntary cerebration, as the philosopher puts it, whereby the act of walking is performed without conscious exertion of the will. It is a magnetism generated in and about a person and his entourage; sometimes exerted solely from within, sometimes exerted solely from without, but most generally, partly from within and partly from without.[7]

During the next fifteen years writers continued to oscillate between the theme of reiterating patronage and arguing for refinements to rule-of-thumb measurement approaches. Adjustments to profits for management remuneration and "normal" returns on tangible assets, averaging past profits for an uncertain number of years, determining the size of the multiplier to be used, and capitalizing surplus profits at a rate of interest were all issues that occupied practitioners involved in valuing businesses for sale, estates, and in tax cases.

In 1914, P. D. Leake, an outstanding exponent on the subject of goodwill, in addressing the Leicester Chartered Accountants' Students' Society, commenced by observing that:

> The term "Goodwill" is in constant commercial use, but its meaning is obscure, and the nature of the value which the word represents is often misunderstood. Goodwill has never been very satisfactorily defined.[8]

He continued with an appraisal of the then existing definitions, and concluded that they were inadequate. In framing his own definition he stated:

> Goodwill, in its commercial sense, is the present value of the rights to receive expected future super-profits, the term "super-profits" meaning the amount by which future revenue, increase, or advantage, to be received, is expected to exceed any and all expenditure incidental to its production.[9]

It was not until 1921 that Leake wrote *Commercial Goodwill,* the second book devoted entirely to the topic, although by 1920 Dicksee and Tillyard had published the fourth edition of *Goodwill and Its Treatment in Accounts.* Leake's exposition of the theory of goodwill valuation, essentially through his advocacy of the "super-profits" method, grew in acceptance and the fourth edition of his book was published in 1948. During this period between 1914 and 1948 he formulated and refined many explanations of the meaning of goodwill, typical of which is:

> Commercial Goodwill is the right which grows out of all kinds of past effort in seeking profit, increase of value, or other advantage. This right is legally protected under various names, both by statute law [e.g., Trade Marks Act, Patents and Designs Acts, Copyright Act, Business Names Act] and by common law, for the use and benefits of the owner.
>
> It is important to bear in mind that this right exists altogether apart from the question of whether or not it has exchangeable value. The exchangeable value of the right depends upon the probability of earning future super-profit—the term "super-profit" meaning the amount by which revenue, increase of value, or other advantage received exceeds any and all economic expenditure incidental to its production.[10]

Leake's underlying thesis was that the value of goodwill is the present value of a super-profit annuity diminishing on a straight-line pattern over the period of influence of the vendor. The best critique of this has been by Carsberg, who, however, concentrated on the methodology of the technique and the difficulties involved in specifying acceptable values for the several variables.[11] While both Dicksee and Leake added something to conceptual clarification, they will best be remembered for their contribution to valuation theory and accounting practice.

Professor W. A. Paton, writing in 1922, devoted one chapter of his book *Accounting Theory* to an analysis of "Goodwill and Going Value." *Inter alia* he defined goodwill as:

> the capitalized value of the excess income which a particular enterprise is able to earn over the income of a representative competitor—a "normal" business—having the same capital investment, the rate used in capitalizing being the rate realized by the representative concern.[12]

In considering the factors and conditions which contribute to the successful creation of this element of a going-concern he added:

> Goodwill may be said to be brought about by three main classes of factors, conditions, and circumstances: (1) services and conditions contributed directly by the principal owners themselves; (2) definite rights or other elements secured by the enterprise which are quite external as far as the owners personally are concerned; (3) indefinite, general, collateral privileges and circumstances which nevertheless have a decided bearing upon successful operation. Examples in the first group are special skill and knowledge with respect to technical processes of production, high managerial ability, exceptional selling capacity, personal credit, social and business connections, general reputation, attractive personality, etc. In the second class may be listed patents, trademarks, copyrights, tradenames, and similar specific rights and conditions. To suggest the character of the third group, established clientele, location and established staff may be mentioned. Favourable trade developments and other highly external and general factors may also give the particular enterprise a temporary advantage.[13]

There can be little doubt that Paton had a profound influence on a succeeding writer, J. M. Yang. In the preface to Yang's book *Goodwill and Other Intangibles,* published in 1927, the indebtedness to Paton for the subject matter is deeply acknowledged. Yang did not define business goodwill *per se,* but discussed instead a number of its economic characteristics. Included in these characteristics were the following: goodwill is based on favourable relationships in business which must contribute toward the improvement of the earning capacity of a firm; goodwill must be more or less persistent and of definite duration if it is to be of any value to a concern; the possibility of its transference must exist; and it must be measurable in monetary terms.[14] He also argued that the broad conception of goodwill "includes the habitual or preferential patronage of customers, the loyalty and adaptability of employees, and the enjoyment of a credit standing which will facilitate the raising of funds when needed."[15]

Yang's writing represents a significant contribution to conceptual development and clarification, but except for mention in Catlett and Olson's 1968 Accounting and Research Study, *Accounting for*

Goodwill, it has not received adequate recognition. Yang was the first to seriously extend the concept from merely consumer's goodwill, to a discussion of factors underlying the creation and consequences of industrial and financial goodwill. No doubt influenced by the growing complexity of modern business organization, he argued that the several factors inducing profitable patronage was too narrow a conception, and that more appropriately it consists of the entire group of influences possessed by a business which contribute to or accompany unusual earning capacity.

In marked contrast to Yang's attention to the underlying causes of superior earning power, the United Kingdom's position at this time still confused a method of calculation with the concept itself. Most probably as a result of the persuasive writings of Dicksee and Leake, Pixley's *The Accountant's Dictionary,* also published in 1927, presented a somewhat dogmatic and seemingly precise seven point summary under the heading of "the nature of goodwill."

1. Goodwill is the present value of expected future super-profits, that is, the balance of profits remaining after providing for all incidental expenditure, including expired capital outlay on wasting assets other than goodwill, and personal remuneration for management, and after also appropriating a sum equal to a normal rate of interest on capital invested.
2. The term "goodwill" includes not only the present value of rights to carry on industrial and commercial enterprises, but it also includes the present value of patent rights, copyrights, and rights to exercise monopolies.
3. The bulk of the value actually existing in the form of goodwill is not recorded in any financial books and accounts. It is generally only that goodwill which has been purchased from a vendor which is so recorded, and which should, therefore, be called "purchased goodwill."
4. The vendor of goodwill cannot reasonably expect to secure for himself the whole benefit of the future annual super-profits; he must divide these fairly with the purchaser.
5. The vendor of goodwill is only entitled to be paid the present value of an annuity equal to his fair share of each future year's super-profits.

6. Super-profits can never exist permanently, because commercial competition is universal and constantly at work, and also because the demand for any commodity or service may slacken or cease owing to changing conditions and new inventions, and, therefore, the annuity which the vendor of goodwill sells should never be treated as being in the nature of a perpetuity.
7. Even if the annuity which the vendor of goodwill sells is treated as an annuity extending over one hundred years, it will be found that 88 per cent of the present value arises out of the payments to be received within the first fifty years of the period.[16]

The following year, in a lecture delivered before the Incorporated Accountants' Students' Society of London. A. F. Saunders noted that the "factors which an accountant has to bear in mind when endeavouring to place a value upon the goodwill of any business will vary in nearly every case." He raised a number of considerations which he believed could affect the value of goodwill, namely:

1. The past record of profits.
2. The capital required.
3. How long the business has been established.
4. Whether the vendors, or competent managers, will continue their services.
5. The nature of the business, whether it deals with necessities, luxuries, partial monopolies, or patents.
6. Whether the business is a manufacturing, wholesale, retail, or professional business.
7. The tenure of the premises occupied, and in the case of leases, of what duration, and the terms upon which renewal can probably be obtained.
8. The number of customers, the volume of business done with them, and the probabilities of customers doing substantial business continuing their custom or patronage.
9. The methods, organization and other matters affecting costing and administration.[17]

In 1937, ten years after Yang's work, H. E. Seed published *Goodwill as a Business Asset*. In this, he comprehensively related goodwill to law associated with trade names, trade marks, patents and designs, and copyrights, thereby developing his thesis that the goodwill of a business can only be valued by valuing the business as a whole. Seed's major contribution to goodwill valuation theory lies in his detailed account of the principles to be followed in estimating future "maintainable profits" of the business, and the percentage return which the purchaser is entitled to expect from capital invested in the undertaking. Seed defined goodwill as:

> The advantage which arises from the good name, reputation and connection of a business; alternatively, the benefit which accrues to the owner of a business from the likelihood that such business will earn, in the future, profits in excess of those required to provide an economic rate of remuneration for the capital and labour employed therein.

He added by way of explanation that,

> In the above definition "business" includes trade and profession; the "economic rate of remuneration" as applied to labour means the amount required to be paid, having regard to the market rates, for labour of the class required (including management and direction); as applied to "capital employed" it means an adequate rate of interest, having regard to the degree of risk attaching to the employment of capital in the particular business concerned, on the capital required to supply the tangible assets of the business, including working capital.[18]

A year later, H. A. Kaner, author of *A New Theory of Goodwill* summed up the trend of accounting writing by claiming that "where the Accountants generally have erred is in confusing a formula for valuing Goodwill with Goodwill itself."[19] After criticizing the superprofits approach often advocated by accountants as being "the" method to be used in valuing goodwill, he offered the following definition;

> Goodwill is that asset possessed by a commercial undertaking which, by embracing that undertaking's reputation, attracts from a portion of the public special preferences, and results in an added value in excess of the surplus tangible assets of the undertaking.[20]

In 1946, Norman S. Young noted in his Commonwealth Institute of Accountants' Research Lecture that early definitions of goodwill stressed the subjectivity aspects of a good name, reputation, and connection, which were true elements in producing goodwill, but that the current preference was to relate goodwill to the notion of superior earnings.[21]

In the same year, Harry Norris injected a note of humour into the writing on goodwill with this definition which reflects the frustration of some writers:

> If X is a live pedigree dog, and Y a dead one, then perhaps X—Y=Z. But Z means nothing in itself. The label 'goodwill' in business accounts closely resembles Z; its use is as sensible as trying to find what makes the dog tick by dissecting it.[22]

But it was about this time, however, that Yang's wider concept of goodwill was becoming popularized. The idea that a more useful concept of goodwill was that of viewing it as virtually all of the factors and conditions which contribute to, or accompany, unusual earning capacity, was extended by George T. Walker. Writing in 1953, he stressed a relationship between the monetary value of goodwill and a firm possessing an above-normal earning capacity.

> By definition, goodwill has no accounting significance except in terms of an earning capacity which is estimated to be above normal. A price is paid for goodwill—a price above the value placed on the other assets—because profits in excess of a normal return on the investment are anticipated. In other words, an enterprise is purchased, not primarily as a means of securing a group of assets, but as a means of securing a stream of income in the future. If the expected stream of income is a normal amount or at a normal rate, all factors considered, no payment is likely to be made for goodwill. If the expected income stream is in excess of normal earnings, a payment will probably have to be made for goodwill. Then, it may be said that the payment for the expected stream of income in excess of a normal return is a payment for goodwill, and that the payment for the expected stream of income equal to a normal return is a payment for the other assets.[23]

Implicit in this earning power concept of goodwill is the recognition that underlying intangible attributes collectively contribute to the goodwill of a business. Because these attributes cannot be valued separately, their demonstrable existence must lie in the excess between the value of a business as a whole and the net value of the various separable resources and property rights. This excess will occur when the expected stream of earnings is greater than that which would sustain the present value of these separable resources discounted at a normal rate.

Wixon and Kell, on the other hand, in the fourth edition of the *Accountants' Handbook* published in 1962, reiterate the several dimensions of business goodwill:

> Increasing acceptance has been given in recent years to the view that goodwill is the value of all favourable attitudes relating to a business enterprise—commercial, industrial, financial and public. Commercial goodwill results from such factors as customers' attitudes, superior products, pleasing surroundings and desirable location. Industrial goodwill is acquired through satisfactory employee relations, including stable employment, high wages, and numerous fringe benefits. Financial goodwill reflects the favourable attitudes of credit institutions, investors, and trade creditors. Public goodwill arises from the general reputation of the company.[24]

Although additional definitions and explanations are available (see Appendix I) the argument expressed by Reg. S. Gynther in 1969 still incisively summarizes present thinking by accountants.

> Goodwill has been a thorny problem in the discipline of accounting for many years. . . . The main cause of the arguments seems to be that the real nature of Goodwill has been submerged in the literature by the methods that we have been forced to use in practice when calculating the total value of entities. . . . Goodwill exists because assets are present, even though they are not listed with the tangible assets. For example, "special skill and knowledge," "high managerial ability," "monopolistic situation," "social and business connections," "good name and reputation," "favourable situation," "excellent staff," "trade names" and "established clientele" are assets in this category. The sum of the value of these assets . . . is the value of Goodwill.[25]

Legal Influence

Although there is no Goodwill Act, statute law and common law acknowledge commercial goodwill as legal property and protect the possessor of a range of rights against unfair competition. Appendix II lists 17 statutes (Section A) and 120 British and American cases (Section B) that have been referenced in selective early accounting literature on the subject of commercial goodwill. It is reasonable to assume that these statutes and cases had an influence on the manner in which accountants valued and accounted for goodwill. Practising accountants, acting for their clients, were (and are) necessarily guided by legal rulings and specific statutes dealing with business connection associated with names, persons and places of business, trade marks, patents and designs, copyright, and the right to exercise monopolies.[26] While a comprehensive review of legal influences lies outside the scope of the present study, some reference to legal opinion emanating from early (British) case law is helpful in corroborating the conceptual evolution of goodwill as it has appeared in accounting literature.

While there is reference that the word "goodwill" appeared in commercial use as early as 1571,[27] it was not until 1810 that the English courts made an explicit attempt to define its nature. In *Crutwell v Lye,*[28] Judge Lord Eldon held that "The goodwill which had been the subject of sale was nothing more than the probability that the old customers will resort to the old place." The courts have since recognised that while this definition is too narrow for general application it heralded the beginning of the popular judicial definition of the term, i.e., that goodwill relates in some way to the concept of patronage.

Through case law the concept of patronage has been examined in many ways, *viz.,* the favourable disposition of customers, the symbol or other distinguishing factor which invokes the favourable response in customers, and the custom itself. The courts, in their endeavor to fix "patronage" into something more concrete, have held that a number of factors may be instrumental in creating goodwill for a business. The following have appeared in case law at one time or another as the major factors causing customer connection:

1 the place or location of the premises,
2 the reputation, personality and skills of the proprietor and/or his staff,
3 the use of an established business name,
4 the quality of the goods and services,
5 the use of advertising, and
6 the absence of competition, especially when it arises out of an agreement between the vendor and purchaser of a business.

In 1858 Lord Cranworth in *Austen v. Boys,*[29] complained that "it is very difficult to give any intelligible meaning to the word 'Goodwill.' " Nevertheless, he attempted to clarify its meaning by adding:

> When a trade is established in a particular place, the Goodwill of that trade means nothing more than the sum of money which any person would be willing to give for the chance of being able to keep the trade connected with the place where it has been carried on. It was truly said in argument that Goodwill is something distinct from the profits of a business, although, in determining its value, the profits are necessarily taken into account, and it is usually estimated at so many years' purchase upon the amount of those profits.

The following year, in *Churton v. Douglas,*[30] the nature of goodwill was fully considered by Vice-Chancellor Page-Wood. In wishing to extend Lord Eldon's 1810 definition he stated:

> Goodwill . . . must mean every advantage—affirmative advantage, if I may so express it, as contrasted with the negative advantage of the vendor not carrying on the business himself—that has been acquired by the old firm by carrying on its business, everything connected with the premises, and the name of the firm, and everything with or carrying with it the benefit of the business. . . . When a person parts with the Goodwill of a business, he means to part with all that good disposition which customers entertain towards his particular shop or house of business, and which may induce them to continue their custom with it.

As noted by Lall,[31] this definition-cum-explanation highlights the element of transferability as a constituent of goodwill.

In 1895 in *Trego v. Hunt,*[32] one of the two leading English cases on goodwill at the turn of the century, Lord Herschell's decision, which later became the basis of the definition of business goodwill used in Lord Halsbury's Laws of England, held that what constitutes the goodwill of a business:

> [It] is the connection thus formed, together with the circumstances, whether of habit or otherwise, which tend to make it permanent. . . . It is this which constitutes the difference between a business just started, which has no Goodwill attached to it, and one which has acquired a Goodwill. The former trader has to seek out his customers

> from among the community as best he can. The latter has a custom ready made. He knows what members of the community are purchasers of the articles in which he deals, and are not attached by custom to any other establishment.

In the same case Lord Macnaghten added,

> What goodwill means must depend on the character and nature of the business to which it is attached . . . it means much more than what Lord Eldon took it to mean. . . . Often it happens that the Goodwill is the very sap and life of the business without which it would yield little or no fruit. It is the whole advantage, whatever it may be, of the reputation and connection of the firm, which may have been built up by years of honest work, or gained by lavish expenditure of money.

Six years later, in 1901 in the case of *Commissioners of Inland Revenue v. Muller & Co.'s Margarine,*[33] the common law position relating to goodwill in its restricted legal meaning was clearly laid out. Lord Macnaghten said:

> What is Goodwill? It is a thing very easy to describe, very difficult to define. It is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start. The Goodwill of a business must emanate from a particular center or source. However widely extended or diffused its influence may be, Goodwill is worth nothing unless it has power of attraction sufficient to bring customers home to the source from which it emanates. Goodwill is composed of a variety of elements. It differs in its composition in different trades and in different businesses in the same trade. One element may preponderate here, and another element there.

In the same case Lord Justice Lindley added:

> Goodwill regarded as property has no meaning except in connection with some trade, business or calling. In that connection I understand the word to include whatever adds value to a business by reason of situation, name and reputation, connection, introduction to old customers, and agreed absence from competition, or any of these things.

While others may care to extend the analysis of legal influence on the conceptual evolution of goodwill it is sufficient to note in this context that running parallel with case law were a number of statutes extending protection to a business, whether old-established or new. Of the seventeen listed in Appendix II (which does not presume to be exhaustive) those separate statutes dealing with patents and designs, trade marks, copyrights, and trade names, protect particular rights, even though possession of such advantageous attributes are normally included within the general umbrella of the goodwill of a business. While more recent English and American cases have dealt with the topic, the emphasis of the courts has been to determine its equitable value when businesses have been sold. It is evident from a perusal of legal literature[34] that the courts have not seriously attempted to construct an all-embracing definition. Instead, they have defined the nature of goodwill according to the context of the particular facts and conditions surrounding specific cases. As facts have varied from situation to situation, so too have definitions and explanations. Perhaps the most persuasive thrust of more recent legal opinion has had to do with the earning power of goodwill, rather than its underlying attributes. Nevertheless, the two approaches are interrelated as the courts have had to determine whether contracts in restraint of trade are void at common law, or whether the restraints sought are reasonable in the circumstances.

An Etymological Enquiry

An etymological investigation into the formation and meaning of accounting terms does not appear to have been incorporated into research on readability and understandability.[35] It is included here because comprehensive illustrations of early English usage in the complete *Oxford English Dictionary* trace the meaning of the word for at least the past one thousand years.

Originally of two words "good" and "will," it is of anglo-saxon derivation and is used as an abstraction to denote a particular type of attitude that is "felt" by a human-being. A pedantic count of the various meanings that have been attributed to these words reveals 103 variations in meaning of "good"[36] and 173 variations of "will."[37] With approximately 18,000 possible combinations, it is evident that only certain usages are applicable to describe a person's particular type of attitude, and the following appear to be the most appropriate. For good; (i) morally excellent or virtuous feelings, and (ii) benevolent or favourable feelings; and for will; (i) desire or disposition to do something, (ii) conscious intention to do some physical or mental action, (iii) power of choice in regard to action, and (iv) consent, acquiescence, permission or favour that something shall happen or take place.

According to the *Oxford Dictionary of English Etymology,*[38] when these two words were coupled together and used as a noun (although not written as one word), its meaning was made up of virtuous from "good" and disposition from "will" to give "virtuous disposition," or more fully, "virtuous, pious, or upright disposition or intentions."[39] This meaning appeared in the Latin form of *bona voluntas,* at least as early as the year A.D. 200, and in the form of Old English as early as the 9th century.[40] As its usage in Old English increased, its semantic content widened and a second class of meaning began to appear in the form of "a state of wishing well to a person, cause, etc.; favourable or kindly regard; favour, benevolence."[41] Sometime late in the 14th century its semantic content was widened further, and a third meaning was attributed to the word, namely, "cheerful acquiescence or consent, given voluntarily, without constraint."[42] From these three meanings it can be seen that the word "goodwill" was employed solely as an abstraction to denote a particular type of attitude or feeling.

With the advent of change from a subsistence to a trade economy at some time between the 14th and 16th centuries—where craftsmen and shopkeepers sold their skills and wares—there arose the habit of "patronage," i.e., for one reason or another some people sought out the skills and wares sold either at a particular place, or manufactured by a particular person, or representative of a particular kind. These people, by their objective acts of associating themselves with one seller (or product) were held to be acting out their feeling of good disposition, or state of wishing well. They had a favourable regard towards the place, person or product, and a voluntary readiness to return for future purchases of goods and services. In short, they had an attitude of goodwill which they were prepared to act upon.

By the middle of the 16th century, the semantic content of the word appears to have been widened further to embrace both the feelings of good disposition of these people, and the objective acts of patronage that they incurred as a direct result of these feelings. It followed that when viewed from the point of view of the recipient of this patronage, "goodwill" came to mean acts of patronage by regular customers. It is important to note this for it marks the start of a divergence in its meaning between its use as an abstraction to denote a particular type of attitude, and its use as an abstraction of a higher order[43] to denote the acts done as a result of this attitude.

During the 18th and 19th centuries commercial activity gained in both momentum and sophistication, such that the notion of goodwill developed from the narrow idea of acts of patronage by regular customers to a wider one encompassing all actual acts of patronage from regular and occasional customers, i.e., to embrace all customer connection. This too is important, for it heralds a breakaway from the reciprocity of feeling of good disposition and act of patronage based on this feeling. It is a reality that not all customer connection which attaches to a business is stimulated through feelings of good disposition. Apart from that patronage which occurs while customers have a feeling of indifference towards the place, person or product, there is that which results from the firm possessing some quasi-monopoly factor such as a patent or a copyright. Lack of available competition may force a customer, with needs to satisfy, to patronise a particular place, person or product while at the same time harbouring distinct feelings of ill-will towards that same place, person or product. However, the recipient of this patronage is unperturbed about such feelings, so long as his business possesses factors or attributes with sufficient attraction to secure this custom.

As a result of this attitude by the recipients of patronage, emphasis on the meaning of the word goodwill has shifted away from an abstraction to denote the actual acts of patronage, and moved towards the attributes themselves, i.e., towards those attributes that are likely to contribute to the performance of these acts. Usage of the word as all actual acts of patronage that are carried out by all customers is no longer the simple manifestation of feelings of good disposition held by regular customers. Rather, it is manifestation of the power of the various attributes possessed by a business.

Curiously there is no reference in etymological works which indicate an association between the meaning of goodwill as it has been shown to evolve, and business profits, even though it has been referenced as possessing saleable value additional to the value of other business assets. It seems clear that through litigation, the courts have defined goodwill as legal property attaching to a business and transferable. Because accountants have been required to value businesses upon dissolution of partnerships, and for sale and tax purposes, the concept of goodwill has been given an expedient residuum connotation and has become submerged by methods of valuation based upon superior earning power concepts.

This has resulted in considerable confusion in understanding as to the real essence of goodwill. Some writers have selected one or more attributes, such as business location, personality, honesty, reputation, and trade name, and have attempted to explain how the overall goodwill which is attached to a firm is established on or created by these factors alone. Accounting literature has in general neglected to argue four points, namely (a) that the attributes themselves are not goodwill, (b) that the attributes are nothing more than the instruments by which acts of patronage may be induced, (c) that the attributes which are effective in promoting patronage vary from firm to firm, and (d) that possession of the attributes (albeit effective in attracting custom) is not an inevitable guarantee of net profit. Moreover, it is implicit in the writings of many accountants that commercial goodwill and business goodwill are the same. This has been shown to be too narrow a conception by some, who have argued convincingly that business goodwill extends to areas other than customer connection, namely, employee, industrial, and financial goodwill.

Conclusion

This overview of the evolution of the meaning of goodwill can best be summarised, in terms of how it is applied to commerce, from two points of view. Firstly, there is the customer. He subconsciously thinks of the word as a label to represent a feeling or attitude of favourable disposition that he possesses towards a particular place, person, or product. Secondly, there is the business which, through its management, views goodwill not simply in terms of acts of patronage by customers, but more as something which is possessed and transferable in the form of attributes, whether they be associated with customer connection, or with employee, industrial or financial goodwill.

Because definitions and explanations of goodwill have tended to mix these points of view along with valuation techniques and amortization processes, the resulting confusion surrounding an understanding of the word has led some people to give it a spurious validity with inherent powers. By itself, however, the word has no inherent power, and no inherent "absolute" conceptual meaning.

Before the question, "What is goodwill?" can be answered, it is necessary to know from which of the above points of view an answer to the question is to be approached, and also the era to which the questionner is referring when asking the question, for it has been shown that the meaning of the word has gained in connotations over time. It is also necessary'to know whether the question refers to the concept of business goodwill *in toto,* or merely to one of its aspects, e.g., customer connection, and whether the question implies valuation or accounting treatment.

FOOTNOTES

[1] Guthrie, p. 425.
[2] Anonymous, 1913, p. 817.
[3] Kaner, p. 9.
[4] Freeman, p. 247.
[5] Bithell, p. 142.
[6] Dicksee, *The Accountant,* p. 40.
[7] Guthrie, p. 425.
[8] Leake, 1914, p. 81.
[9] Leake, 1914, p. 82.
[10] Leake, 1948, pp. 2, 18.
[11] Carsberg, pp. 10-15.
[12] Paton, p. 313.
[13] Paton, pp. 315-16.
[14] Yang, pp. 22-37.
[15] Yang, p. 87.
[16] Pixley, p. 526.
[17] Saunders, May 1928, p. 354.
[18] Seed, p. 8.
[19] Kaner, p. 15.
[20] Kaner, p. 17.
[21] Young, November 1946, p. 475.
[22] Norris, p. 110.
[23] Walker, George T., 1953, p. 213.
[24] Wixon and Kell, p. 14.
[25] Gynther, p. 247.
[26] Leake, 1948, pp. V-VI.
[27] Oxford English Dictionary, Wills and Inventories of the Northern Counties of England (publication of the Surtees Society, 1835) 352, "I gyue to John Stephen . . . my whole interest and good will of my Quarell (i.e., quarry)."
[28] 1810, 17 Ves. 335.
[29] 1858, 27 L.J. Ch. 714.
[30] 1859, 28 L.J. Ch. 841.
[31] Lall, p. 67.
[32] L.R. 1896, A.C. 7.
[33] 1901, A.C. 217.
[34] Anonymous, Columbia Law Review, pp. 660-731.
[35] See for example Smith, J. E. and Smith, N. P. for readability; Haried, A. F. for semantic dimensions; and Adelberg, A. H. for understandability.
[36] Oxford English Dictionary, Volume IV, pp. 287-96.
[37] Oxford English Dictionary, Volume XII, pp. 129-39.
[38] Onions, pp. 405-406.
[39] Oxford English Dictionary, Volume IV, p. 296.

[40] For example, Oxford English Dictionary, C 893 He [Titus] waes swa godes willan baet [etc.].; C 825 Mid scelde godes willan dines du zebezades usic.

[41] Oxford English Dictionary, Volume IV, p. 297.

[42] Oxford English Dictionary, Volume IV, p. 297.

[43] Chase, pp. 57-58.

Appendix I

A Chronology of Selective Definitions of Goodwill (1882-1981)

Bithell, 1882, p. 142.

The advantage connected with an established business of good repute. A well-established business presents an expectation of profits to any one entering upon it, and is worth paying for. Anyone having such a business and who is willing to relinquish the expectation of the business by transferring it for consideration to someone else can do so by what is technically called "selling the Goodwill of that business."

Harris, 1884, p. 256.

Goodwill may be defined as being the money value over and above the value of the actual assets of a concern (such as book debts, stock-in-trade, machinery, etc.) which can be realized in cases of death, dissolution, retirement, or liquidation.

Bourne, 1888, p. 107.

Goodwill may be defined as the benefit and advantage accruing to an existing business from the regard that its customers entertain towards it, and from the likelihood of their continued patronage and support.

Marshall, 1890, p. 430.

Goodwill or business organization and connection.

Moore, 1891, p. 282.

Goodwill is just another name to designate the patronage of the public.

Roby, 1892, p. 289.

Goodwill is, properly speaking, the benefit or advantage which rests only on the Goodwill, or kind and friendly feelings of others. It is a hope or expectation which may be reasonable and strong, may rest upon a state of things which has grown up through a long period, and been promoted by large expenditure of money. And it may be worth all the money it has cost, and a great deal more; but it is often all nothing more than a hope grounded upon a probability.

Goodwill is the advantage or benefit which is acquired by an establishment or a man beyond the mere value of the capital, stock, funds, or property employed therein, or by him, in consequence of the general public patronage and encouragement which it or he receives from constant or habitual customers, clients, or patients, on account of its or his local position, or common celebrity, or reputation for skill, or affluence, or punctuality, or from other accidental circumstances, or necessities, or even from partialities or prejudices.

Whatley, 1893, p. 28.

There is no item of capital of more uncertain valuation than the goodwill of a business; it depends so much upon the contingencies of trade that it is never safe to regard it as of permanent value. The best plan to arrive at its value would be to take it as being worth three or five years' purchase of the average profits of a stated period.

Warren, 1894, p. 97.

A feeling of Goodwill towards the particular house of business with which customers deal.

Trego v. Hunt, 1896, p. 7.

Goodwill may be defined as every advantage that has been acquired by a firm in the carrying on its business, whether connected with the premises in which the business has been carried on, or with the name of the firm, or with any other matter carrying with it the benefit of the business.

Dicksee, 1897, p. 40.

The benefit arising from connection and reputation, the probability of the old customers going to the new firm which has acquired the business.

The value of that reputation which a business has acquired during its continuance, which induces the confidence or expectation that the same, or an increasing patronage will continue to be extended so long as the business is conducted in the same place upon the same principles.

Densham, 1898, p. 570.

Goodwill is the connection and reputation of a business, together with the chance of keeping and improving it. The value of Goodwill may also be defined as the present value of future profits.

Guthrie, 1898, p. 425.

The value in pecuniary terms of this intangible thing is the difference between the value of the normal results of the working of any business or profession which may be established by and worked by any person in any place, and the results of working any individual business of a similar character.

Phillpotts, 1899, p. 181.

. . . what is sought to be obtained by getting the goodwill of any trade or profession is "the old customers of the firm."

Whitehill, 1899, pp. 702-703.

The item of goodwill legitimately appearing in a Balance Sheet is the amount which represents or indicates the value of an acquired right, permanent or temporary, to trade, make profit, or earn or obtain income; or, similarly, the right to stand in the vacated place of a trader or profit maker or income earner to do as he has done to give beneficial effect to the acquirement.

Lisle, 1899, p. 134.

Goodwill is the monetary value placed upon the connection and reputation of a mercantile or manufacturing concern, and discounts the value of the turnover of a business in consequence of the probabilities of the old customers continuing.

Hunter, 1901, p. 351.

Goodwill exists as a benefit or advantage accruing to the firm, in addition to the value of its property, derived from its reputation for promptness, fidelity and integrity in its transactions, from its mode of doing business, and other incidental circumstances, in consequence of which it acquires general patronage from constant and habitual customers.

Commissioners of Inland Revenue v. Muller & Co's Margarine, 1901, p. 217.

Goodwill is the benefit and advantage of the good name, reputation, and connection of a business. It is the attractive force which brings in custom. It is the one thing which distinguishes an old-established business from a new business at its first start.

Gundry, 1902, p. 662.

. . . define goodwill as the capitalised increment of value over the actual original cost, basing the profits at a given rate of interest.

Anonymous, 1902, p. 840.
The advantage which is possessed by occupying the premises which were tenanted by the former firm, and the chance which is thereby given of the customers being attracted to those premises.

Smith, 1904, p. 48.
Goodwill was, of course, a very indefinite asset. The amount for which it could be sold depended on many considerations—past profits, prospects, personal influence of some of the officials, and popular fancy.

Cleminson, 1907, p. 784.
The advantage or benefit which is acquired by an establishment beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant and habitual customers on account of its local position or common celebrity, or reputation for skill, or affluence, or punctuality, or from any other accidental circumstances and necessities, or even from partialities or prejudices.

Morley, 1908, p. 43.
The value of the good repute of a business; and the probability of its customers returning to do business there.

Kirkland, 1910, p. 344.
Goodwill, generally described, is the custom or connection formed of any trade, business, or even profession. It is that factor in an existing and established trade, business, or profession which gives reasonable ground for the expectation and assumption that customers will come and will continue to come, to the old trader or professional man and their successors to a greater extent than if the business or profession were but newly started.

Bentley, 1911, p. 157.
Goodwill may be defined as the value of the benefits or advantages which attach to a particular business, in addition to the actual value of the property used in its conduct. This may be brought about through the value of trademark, or the reputation or skill of the organization, the reputation of the goods sold, peculiarly advantageous business connection, advantageous location, etc. It may also include the title to trade-marks, copyrights, etc., carrying all of the privileges enjoyed from their use by the former owners.

Dow, 1912, p. 96.
Goodwill is a consideration for the benefit of a trade or custom which the party who is disposing of a business has gathered together, and the amount of the consideration will depend upon the profits earned and other circumstances.

Hatfield, 1912, p. 107.
Goodwill represents the value of business connections, the value of the probability that present customers will continue to buy in spite of the allurements of competing dealers.

Anonymous, 1913, p. 816.
Goodwill is an immaterial or intangible asset, which represents the value of superior organisation, high reputation, advantageous location, or of any other circumstances which gives greater earning power to a business than ordinary returns upon capital cost invested.

Leake, 1914, p. 81.
Goodwill—The privilege, granted by the seller of a business to the purchaser, of trading as his recognised successor; the possession of a ready-formed "connexion" of customers, considered as an element in the saleable value of a business, additional to the value of the plant, stock-in-trade, book debts, etc.

> Goodwill, in its commercial sense, is the present value of the right to receive expected future super-profits, the term "super-profits" meaning the amount by which future revenue, increase or advantage, to be received, is expected to exceed any and all expenditure incidental to its production.

Wildman, 1914, p. 142.

> By goodwill is meant, that intangible possession or qualification which is capable of producing recurring income or by virtue of which recurring sales may be made. It is the influence which the proprietor or his organization has upon the purchasing public through which he is enabled to attract and retain patronage. In some cases it may be the power of controlling certain patronage. It is that particular power of attraction whereby the proprietor causes the buyer to seek him or his place of business when in the market for the kind of goods which the proprietor has for sale.

Kerr, 1915, p. 232.

> Goodwill is the value of the connection between the corporation and its customers, and the chances of being able to hold and to develop that connection.

Douglas, 1915, p. 184.

> Goodwill is the value of a business in itself as distinct from the value of the physical assets used in such business.

Pattrick, 1916, p. 279.

> Goodwill is the fillip towards prosperity that a business enjoys over and above the ordinary return for the investment of labour and materials, interest on capital and a margin for insurance of capital.

Hunter, 1918, p. 260.

> Goodwill means the probability of old customers returning.

Anonymous, 1918, p. 452.

> Goodwill has two aspects—(1) perfected organizations of the business, and (2) expectation of future profits from past connections and reputation.

Walton, 1919, p. 379.

> Goodwill is based on the ability of an enterprise to make a greater regular profit than the normal amount demanded by an investor. It must, perforce, be a matter of growth.

Spackman, 1919, p. 29.

> The goodwill of a business consists of all the various advantages in addition to the tangible assets, which aid in carrying on its trade, and in making it profitable.

Paton and Stevenson, 1919, p. 529.

> Goodwill may then be defined as the capitalized value of the excess income which a particular firm, because of greater efficiency or any monopolistic advantages, is able to realize over a normal enterprise in the same industry and having the same capital investment.

Conyngton (1921), p. 340.

> Goodwill may be defined as the profit-producing power of an established business beyond mere interest and replacement returns; or, from another point of view, as the value of an established business over and above the value of its material assets.

Maughan, 1921, p. 239.

> Goodwill is value of a business over and above its tangible assets and capital stock. One of the differences between a recently formed and an old established successful business.

Paton, 1922, p. 313.

> Goodwill may be defined as the capitalized value of the excess income which a particular enterprise is able to earn over the income of a representative

competitor—a "normal" business—having the same capital investment, the rate used in capitalizing being the rate realized by the representative concern.

Leake, 1922, p. 699.

Commercial goodwill is the right which grows out of all kinds of past effort in seeking profit, increase of value, or other advantage.

Anonymous, 1923, p. 249.

The value of goodwill may be taken as the present value of the probable future profits of the concern after making due allowance for interest on capital and the personal profit-making capacity of the partner or partners.

Armstrong, 1924, p. 282.

Goodwill is the saleable value attaching to the connection and reputation of a business. It should represent the value of the business to make surplus profit after charging interest on the capital employed.

Goodwill is that indefinable something that you can neither eat, drink, nor taste, nor drive a nail into.

Couchman, 1924, p. 131.

When the business has begun to roll along smoothly, it accumulates what might be called 'momentum', and the expense or effort necessary to keep it in motion is not so great as that needed to start it. Therefore an organization desiring to enter certain activities sometimes prefers to buy a going business—that is, one which has already acquired momentum—and is willing to pay for such a business an amount in excess of the net book value of its assets. In accounting this amount is termed "goodwill."

Lenhart, 1925, p. 1.

Goodwill is an intangible and fluctuating asset which represents the value of a business over and above the money, other intangibles and accumulated profits invested in it.

Curtis and Cooper, 1925, p. 1968.

Goodwill is an intangible asset, the value of which is based on the capitalized value of the profits of a business which are in excess of a fair return on the net assets.

Hall, 1926, p. 273.

The value attaching to the reputation of a business and to the likelihood that custom will continue to be attracted in the future as in the past, notwithstanding change in the proprietorship.

Anonymous, 1926, p. 406.

Goodwill is the present value of the right to receive expected future superprofits.

Parkinson, 1927, p. 95.

Goodwill is that benefit which arises, from the local position or general reputation of a particular establishment, for fair dealing, skill, affluence, or punctuality, and peculiar to that particular establishment.

Anonymous, 1927, p. 205.

An amount paid for goodwill really represents a premium paid to secure an extra profitable opening for the employment of capital.

Anonymous, 1928, p. 547.

Goodwill has been defined as the advantages that have been acquired by an established firm in carrying on its business, whether connected with the premises in which the business is carried on, or with the name of the firm, or with any other matter carrying with it the benefit of the business.

Saunders, 1928, p. 382.

The acquisition of goodwill may be regarded as the payment of a capital sum for future super-profits, the price being looked upon as the capital value of an annuity for a term of years.

Barton, 1929, p. 27.

Goodwill is what makes you come back to a store a second time.

Geir and Mautner, 1930, p. 16.

Goodwill comprises the capitalized value of the excess income which a particular concern, because of the peculiar advantages of prestige, efficiency or location attaching to its established business, is able to realize over a normal enterprise in the same industry having the same capital investment.

Foreman, 1930, p. 179.

Economists have viewed goodwill almost entirely as a state of the consumer's mind and therefore as an economy external to the productive process. Indeed, it has often been described as the reputation or public esteem which an enterprise enjoys in the eyes of the public. Again, it has been explained as the habit or custom which leads men to purchase goods from a particular person or company.

American Institute of Accountants, 1931, p. 67.

Goodwill is the present value of the right to receive expected future super-profits.

Walton, 1931, p. 860.

Goodwill is the extra benefit accruing to a business by reason of its connection with customers, which may have been built up from a number of causes, chief of which are the reputation and efficiency of the proprietors, the reputation of the goods, the locality of the business, or the monopoly enjoyed as in the case of a patent.

Leake, 1933, p. 15.

Goodwill, in its commercial meaning, is the transferable right which grows out of all kinds of past effort in seeking profit, increase of value, or other advantage.

Leake, 1934, p. 513.

Commercial Goodwill may include any and all such property as business connection associated with names, persons and places of business, trademarks, patents and designs, copyright, and the right to exercise monopolies.

Coomber, 1935, p. 197.

In its widest sense, Goodwill means just "good will", a state or relationship between two parties, leading to mutual respect support and reliance. A buyer of goods dealing with a particular seller with whom this relationship exists may do so because he is satisfied that the goods he will obtain will be of a certain standard, or because the seller's place of business is convenient, or because he was satisfied with goods previously obtained from this particular vendor. Again, it may be the reputation for skill in the case of a doctor, or the knowledge and subtley in the case of a lawyer which attracts custom. Or it may just be that repeated advertisement has induced the belief that the advertiser's goods are better for the buyer than those of anybody else, with the result that he demands them without another question. All these types of relationships are forms of goodwill.

Bogan, 1935, p. 250.

From an accountancy standpoint I think it is now universally conceded that goodwill should represent the capitalized value of "super" profits, i.e., the profit over and above that profit which would be regarded as an ordinary commercial yield in the particular class of business.

Seed, 1936, p. 8.

Goodwill is the advantage which arises from the good name, reputation and connection of a business; alternatively, the benefit which accrues to the owner of a business from the likelihood that such business will earn, in the future, profits in excess of those required to provide an economic rate of remuneration for the capital and labour employed therein.

Goodwill represents the probability of the retention by a professional man of the confidence of his clients and their continued employment of his services and, in the case of a commercial undertaking, the likelihood of customers continuing to deal with it, with all the implications that such likelihood of continuance of profitable association carries with it.

Finney, 1937, p. 308.

Goodwill may be defined as the capitalized value of the profits of a business which are in excess of a normal or basic return on the capital exclusive of goodwill.

Sanders, Hatfield and Moore, 1938, p. 67.

The excess of the total value of the assets of a going concern over that part of the value which can be allocated to specific assets.

Bloomberg, 1938, pp. 9-10.

. . . financial goodwill . . . relates to the friendly attitude of the money market toward a company. Industrial goodwill has to do with the nature of the employer-employee relationship. Buyer goodwill or buyers' attachment to a company . . . is the favourable attitude of the persons to whom a concern sells.

Harris, 1939, p. 567.

Goodwill may be broadly defined as "The capacity of a business to earn profits."

Anonymous, 1939, p. 965.

Goodwill may be defined as that characteristic of an undertaking which enhances the undertaking's reputation, attracts from a portion of the public special preference, and results in an added value in excess of the surplus tangible net assets of the undertaking.

Moffatt, 1941, p. 556.

The conception that goodwill is that part of the purchase price paid which exceeds the value of the tangible assets acquired is widely accepted.

Leake, 1943, pp. 21-22.

The term "commercial goodwill" covers the whole field of rights growing out of all past effort (in seeking profit, increase of value, or other advantage). . . . (These rights may include any and all such property as business connections associated with names, persons, and places of business, trade-marks, patents and designs, copyrights, and the right to exercise monopolies.)

Norris, 1946, p. 110.

If X is a live pedigree dog, and Y a dead one, then perhaps X—Y=Z. But Z means nothing in itself. The label "goodwill" in business accounts closely resembles Z: its use is as sensible as trying to find what makes the dog tick by dissecting it.

Nicholls, 1948, p. 34.

I have had just a few examples (of Stock Exchange quotations) taken out, comparing the in globo values of certain public companies and comparing these values with the net disclosed tangible assets. Of course, it is possible stretching the matter a little too much to call the difference between the net tangible and the overall values, "goodwill". . . . But, without being too precise, the description "goodwill" must largely fit my explanation of the differences.

Sanderson, 1950, p. 37.

Goodwill will ever be like law and the mushroom—something you don't know what you've got until it's too late.

Emery, 1951, p. 560.

In general, goodwill is looked upon as the economic advantage of friendly and harmonious relationships enjoyed by a business firm throughout the different phases of its operations. This advantage evidences itself in the form of earnings in an amount greater than that expected in a typical firm in the industry with a similar capital investment.

Walker, 1951, p. 100.

At one time goodwill was presumed to exist only in connection with the customer. Later the concept was expanded to include industrial and financial relations, whereas goodwill, in an accounting sense, is now defined in terms of the estimated value of future profits in excess of normal return, and without any limitation as to the probable source of the expected profits.

Walker, 1952, p. 1.

It may be the personal reputation of the owner, the reputation of the products, the results of advertising, the likes and dislikes of the public, the location of the business, the absence of competition, or any one of a thousand other things that make up this thing called goodwill.

Walker, 1953, p. 213.

Purchased goodwill is, by definition, the present worth of an anticipated future income stream.

Wright, 1956, p. 381.

Goodwill has its orthodox meaning of the benefit of an established connection, the expectation that customers will return to the old firm, and in this sense its value must be linked with some concept of super-profit.

Professional goodwill is what one person will pay and another accept, for an established connection.

Schumann, 1960-61, p. 113.

Goodwill represents the portion of the expected profits of a business in excess of so called normal profits for which a buyer is willing to pay and which a seller is willing to give up.

Virgil, 1963, p. 33.

Accounting should recognize as an asset only that goodwill which is purchased when a firm acquired the properties of another company, this being the excess of the purchase price over the appraised fair market values of the tangible properties of the company.

Brown, 1966, p. 458.

The goodwill of an enterprise may be defined, as the excess of the value of that enterprise over the aggregate value of its net assets at any point of time.

Lall, 1967, pp. 71-72.

Significant of the factors that make the value of goodwill are: reputation of the product manufactured or sold, monopolistic rights, location of the business, personal qualifications of the head of the business, possession of favourable contracts, manufacturing efficiency, satisfactory labour/management relations, adequate source of capital, credit standing, political advantages, in general, good management.

Catlett and Olson, 1968, p. xv.

The concept of business goodwill value is defined as the difference between

> the total value of an enterprise and the aggregate value of its separable resources and property rights, less liabilities.

Gynther, 1969, p. 247.

> Goodwill exists because assets are present, even though they are not listed with the tangible assets. For example, special skill and knowledge, high managerial ability, monopolistic situation, social and business connections, good name and reputation, favourable situation, excellent staff, trade names and established clientele are assets in this category. The sum of the value of these assets is the value of the goodwill.

Hendriksen, 1970, pp. 432-433.

> From an accounting point of view, three major conceptions of goodwill appear frequently in the literature: (1) the evaluation of intangible attitudes toward the firm; (2) the present discounted value of the excess of expected future profits over that considered a normal return on the total investment not including the goodwill; and (3) a master valuation account — the excess of the value of the business as a whole over the valuations attaching to its individual tangible and intangible net assets.

Eitman, 1971, p. 48.

> Purchased goodwill is not a finite-lived asset like a building, equipment or a patent; it is an investment by the buying enterprise in a group of intangible resources of the selling company that are of a rather elusive nature. As an "investment asset," it should be carried at an unamortized amount in the balance sheet as long as there is no evidence that its value has been impaired or that its term of existence has become limited.

Miller, 1973, p. 285.

> The term "goodwill" is necessary for the accountant because he attempts to disaggregate the purchase price for an organized whole only by isolation of elements which are classifiable according to traditional accounting procedure and which can be valued arbitrarily in terms of some historic costs or external market values. These measurements imperfectly reflect any contribution to or sum of enterprise value; the notion of goodwill as a residuum is necessary to neutralize the effect of this invalid method of decomposition.

Lee, 1973, p. 177.

> Goodwill . . . has been defined as the purchase price to an acquiring company of profits over and above the purchase price of the acquired net tangible assets necessary to produce these assets. In other words, it is the difference between the value of the acquired entity as a whole and the sum of the separate values attributed to the acquired tangible net assets. It can include, therefore, such intangible assets as patents, trademarks and copyrights.

Barlev, 1973, p. 305.

> It is claimed here that goodwill is an asset created by the [process of business] integration, and that its magnitude is a function of the characteristics of all the constituents of the merger.

Gibson and Francis, 1975, p. 167.

> Goodwill on consolidation is the term used to describe the excess of the cost of investments in subsidiaries over the book value of the equity acquired.

Fess and Niswonger, 1981, p. 263.

> Goodwill is an intangible asset that attaches to a business as a result of such favorable factors as location, product superiority, reputation and managerial skill. Its existence is evidenced by the ability of the business to earn a rate of return on the investment that is in excess of the normal rate for other firms in the same line of business.

Appendix II

Selective Statute and Case Law Influencing the Conceptual Clarification of Commercial Goodwill

Section A

Statutes

Fine Arts Copyright Act, 1862
Merchandise Marks Act, 1862, 1887
Partnership Act, 1890
Musical (Summary Proceedings) Copyright Act, 1902
Musical Copyright Act, 1906
Trade Marks Act, 1905, 1919
Patents and Designs Acts, 1907 to 1932
Copyrights Act, 1911
Bankruptcy Act, 1883, 1914
Registration of Business Names Act, 1916
Agricultural Holdings Act, 1923
Merchandise Marks Act, 1926
Landlord and Tenant Act, 1927
County Court (Landlord and Tenant) Rules, 1928
Companies Act, 1929
Statute of Monopolies, 1623
Stamp Act, 1891

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Section B

Case Law

Appleton Water Works v. Railroad Commission, 154 Wis. 121, 147
Arundel v. Bell (1883), 52 L.J. Ch. 537
Austen v. Boys (1858), 27 L.J. Ch. 714
Banks v. Gibson (1865), 34 Beav. 566
Barrow v. Barrow (1872), 27 L.T. (N.S.), 431
Bennett, In re (1899), 1 Ch. 316
Blackstone v. Miller, 188 U.S. 189, 205
Boorne v. Wicker (1927), 1 Ch. 667
Booth v. Curtis (1869), 17 W.R. 393
Boyce v. Morris Motors, Ltd. (1927), 44 R.P.C. 105
Bright & Brothers, Ltd. v. Bright (Outfitters) Ltd. (1922), 67 S.J., 112 C.A.
Brinsmead v. Brinsmead (No. 1) (1913), 30 R.P.C. 137; (1913), 29 T.L.R. 237, 706
Broad v. Jollyfe, Cro. Jac. 596
Brock & Co. v. Pain (1912) 28 R.P.C. 697, C.A.
Brunswick and T. Water District v. Maine Water Co., 99 Me. 371, 376
Burchell v. Wilde (1900), 1 Ch. 551
Byrne v. Statist Co. (1914), 1 K.B. 622

Carpenter v. Smith (1842), 1 Web. P.C. 540
Cash v. Cash (1902), 19 R.P.C. 181; 86 L.T. 211
Cedar Rapids Water Co. v. City of Cedar Rapids, 118 Iowa 234, 262
Charrington v. Simpson (1934), 1 K.B. 64
Chittenden v. Witbech, 50 Mich. 401
Christy & Co. v. Tippes & Son (1905), 21 R.P.C. 97, 775
Churton v. Douglas (1859), 28 L.J. Ch. 841
Commissioners of Inland Revenue v. A. Lloyd & Sons, Ltd. (8 A.T.C. 443)
Commissioners of Inland Revenue v. Muller, Ltd. (1901), A.C. 217
Commissioners of Inland Revenue v. Ramsay (1935), 14 A.T.C. 533
Cooper v. Metropolitan Board of Works (1884), 25 Ch. 472
Croft v. Day (1843), 7 Beav. 84
Crutwell v. Lye (1810), 17 Ves. 335
Curl Bros. v. Webster (1904), 1 Ch. 685
David and Matthews, Re (1899), 1 Ch. 378
Davies v. Hodgson (1857), 25 Beav. 177, 182, 183
Dawson v. Beeson (1882), 22 Ch. D. 504, 507, C.A.
Densham's Trade Mark, In re (1895), 2 Ch. 176
Eastern Outfitting Co. v. Manheim, 59 Wash. 428
Eastman Co.'s Trade Mark (1898), A.C. 571
Elias v. Grovesend Tinplate Co. (1890), 7 R.P.C. 466
England v. Downs (1843) 6 Beav. 269
Ewing v. Buttercup Margarine Co. (1917), 2 Ch. 1; 34 R.P.C. 232; 33 T.L.R. 321
J.C. & J. Field, Ltd v. Wagel Syndicate, Ltd. (1900), 17 R.P.C. 266
Foley v. Fletcher (1858), 28 L.J. Ex. 100
Gargan v. Ruttle (1931), I.R. 152
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Gordon v. Knott, 199 Mass. 173
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Health Promotion, Ltd., Re (1932), 1 Ch. 65
Hill v. Fearis (1905), 1 Ch. 466
Hitchman Coal and Coke Co. v. Mitchell, 245 U.S. 229, 252
Homer v. Ashford (1825), 3 Bing 322
Hookham v. Pottage (1872), 8 Ch. App. 91
Horlick's Malted Milk Co. v. Summerskill (1917), 34 R.P.C. 63
Hudd v. Matthews (1930), 2 K.B. 197
Hunter v. Dowling (1895), 2 Ch. 223
Inland Revenue v. Angus (1889), 23 Q.B.D. 590
Jennings v. Jennings (1898), 1 Ch. 378
Jones v. Commissioners of Inland Revenue (1919) 7 T.C. 310
Kenrick v. Lawrence (1890), 25 Q.B.D. 99
Kingston Miller & Co. Lim. v. Thos. Kingston & Co. Lim. (1912), 1 Ch. 575
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McDowell's Application, In re (1926), 43 R.P.C. 313
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Morgan v. Seaward (1837), 1 Web. P.C. 192
Morgan v. Windover (1890), 7 R.P.C. 131
National Biscuit Co., In re (1902), 1 Ch. 783
National Water Works Co. v. Kansas City, 62 Fed. 853, 865
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Outram v. London Evening Newspapers Co. (1911), 28 R.P.C. 308; 27 T.L.R. 231
Oxo, Ltd. v. King (34 R.P.C. 135)
Patent Exploitation, Ltd. v. Siemens & Co. (1904), 21 R.P.C. 549
Pinto v. Badman (1891), 8 R.P.C. 181
Pioneer Telephone and Telegraph Co. v. Westenhaver, 29 Okl. 429, 446
Pomeroy (Mrs.) Ltd. v. Scale (1906), 22 T.L.R. 795; T.L.R. 170
Powell's Trade Mark, In re (1893), 2 Ch. 388
Ransome v. Graham (1882), 51 L.J.Ch. 897
Rawson v. Pratt, 91 Ind. 9
Rickman v. Thierry (1896), 14 R.P.C. 105
Ridgway Co. v. Amalgamated Press (1911), 29 R.P.C. 130; 28 L.T.R. 149
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THE ACCOUNTANT-HISTORIANS OF THE INCAS

Abstract: The quipu was the ingenious, knotted-string device utilized throughout the Incan empire for recording data within the decimal system. Although quipu experts have often been thought of as managerial or governmental accountants, the writings of the early chroniclers of Peru reveal that quipu specialists were more than accountants. Quipucamayocs were also the historians of the Incas.

Historians usually refer to the quipu as the mnemonic, mathematical, knotted-string device that was used throughout the Incan empire for the purpose of keeping careful accounts within the decimal system, even though no writing existed in that culture. Descriptions of the construction, function, and utilization of the quipu have appeared in the literature[1] and there has been interest in the quipu in terms of its possible role in the origin of the concept and practice of double entry bookkeeping.[2] But not much has been written about the individuals who were responsible for the preparation and the interpretation of the quipus: the quipucamayocs. This article describes the role and the world of these "accountants" of the Incas.

The Accountant-Quipucamayoc

At the outset, we should note that it is rather misleading to think of the quipucamayocs as accountants, as we use the term today. Accounting is generally a matter of recording transactions by means of a common denominator: money. But the Incan civilization had no money, and its vast quantities of gold and silver had no convertibility in our common-denominator sense. The empire's gold and silver were highly valued because they could be converted into beautiful objects for the rulers to use and to wear.[3] Quipucamayocs recorded statistical quantities, not monetary equivalents, as do twentieth-century accountants.

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The Incan dynasty spanned an era of some four hundred years. The legendary Inca, Manco Capac—Son of the Sun—was the first of the dozen rulers of the empire which was greatly expanded under Pachacuti, Tupa Inca, and Huayna Capac (the ninth, tenth, and eleventh Incas). The expansion spread the empire north from Cuzco to the border of what is now Colombia and south to Santiago, Chile (about 2500 miles long) and involved approximately the hundred years before the Spanish conquest in 1533. At its greatest geographical extent, the empire comprised some 380,000 square miles, an area approximately equal to all of the Atlantic seaboard states combined.[4] By the time Columbus arrived in the New World, the Incan civilization was already a functioning, far-flung, socialistic economy.

Raw data was necessary for the central planners' decision making, and among the vital statistical chores done by the quipucamayocs was the recording of births and deaths on an annual basis. Cieza de León points out the importance of the yearly census:

> . . . for this was necessary for the levying of the tributes as well as to know how many were available for war and those who could assume the defense of the villages. This was an easy matter, for each province at the end of the year had a list by the knots of the quipus of all the people who had died there during the year, as well as of those who had been born.[5]

Surely these census quipucamayocs would have had to follow standardized rules for recording. When one studies the superb organization and order that was extant during the expansion of the empire, according to the early chroniclers (e.g., Cieza), it seems clear that a great deal of uniformity must have existed in the systems of accounting. Too much flexibility would have been an anathema to Incan accounting, even as it would be today when considering the accounting systems of modern planned economies.

After a tribe was conquered by the Inca, its governance was dictated by an administrative team from Cuzco, the capital, and the team would include quipucamayocs. Each village and region paid tribute to the Inca, although not every citizen was required to pay. Exempted from tribute, according to Father Blas Valera, were those of imperial blood, all Curacas (government officials/administrators) and their families, army officers and soldiers on active duty, women, men under 25 and over 50 years of age, the sick, priests, and subordinate officials while in office.[6] The official (and thus exempt) status of quipucamayocs is evident from the drawings of Poma de Ayala who depicted them with their quipus and identified them with titles such as provincial administrator, secretary and advisor to the Inca, senior accountant and treasurer, and astrologer.[7] Garcilaso de la Vega also indicated that the quipucamayocs were "exempted from all tribute as well as from all other kinds of service" because their responsibilities were "so great and so absorbing."[8]

Jiménez de la Espada reported that quipucamayocs were given very good allotments of all sorts of sustenance for each month of the year as well as women and servants.[9] They were to have "no other task other than that of their *quipos,* and of having them prepared and ready, with the correct information."[10] Because of his significant (Curaca) position in the society, a favored quipucamayoc could enjoy special luxuries, as noted by Father Valera:

> Certain specially prized goods, such as gold, silver, copper, precious stones, feathers, paints, and dye-stuffs, were restricted to the use of the imperial caste and to such favored curacas as might be honored with permission to use them.[11]

These items came from the tribute surplus, after the royal wants had been satisfied.

The form of the tribute varied greatly, depending upon factors such as the prosperity of the natives, availability of metals, fertility of the land, and the results of the annual census. In addition to manual labor to work in the mines, fields, and to build public buildings, tribute could consist of such things as corn, chuno (dehydrated potatoes), blankets, coca, lances and slings. If a conquered area was deemed too poor to pay tribute, the Inca ordered that each inhabitant "turn in every four months a large quill full of live lice" as a form of taxation, until such time as the natives became more prosperous.[12] The concept of tribute was thus introduced immediately after each conquest.

Quipucamayocs held critical positions in the operation of this system of taxation. Theirs was the job of calculating and recording the amount of labor or other items furnished and still due, as can be seen from these descriptions by Cieza:

> The tribute paid by each of these districts where the capital was situated, and that turned over by the natives, whether gold, silver, clothing, arms, and all else they gave, was entered in the accounts of the *(quipu-)camayocs,* who kept

> the quipus and did everything ordered by the governor in the matter of finding the soldiers or supplying whomever the Inca ordered, or making delivery to Cuzco; but when they came from the city of Cuzco to go over the accounts, or when they were ordered to go to Cuzco to give an accounting, the accountants themselves gave it by the quipus, or went to give it where there could be no fraud, but everything had to come out right. Few years went by in which an accounting of all these things was not made.[13]

> They saw, by the knots, the amount of labour that the Indians had performed, the crafts they had worked at, the roads they had travelled over by order of their superiors, and other tasks on which they had been employed. All this was deducted from the tribute that was due.[14]

From these descriptions, it can be seen that a certain amount of travel was part of the job. Although the capital city of Cuzco was the heart of the empire, it was distant from most of the provinces. An accountant from the southern part of the land might have a trip of 1,500 miles to cover before arriving in Cuzco. The roads, however, were excellent. The Incas built more than 10,000 miles of all-weather roads, including the 3,250-mile Royal Road and the 2,520-mile Coastal Road.

The quipucamayocs had the use of a rapid and efficient communication system that covered the immense distances over these well developed roads. They sometimes sent their information-laden quipus to other parts of the empire via the *chasqui* system. This nationwide network stationed couriers on duty perhaps every couple of miles, more or less, depending upon the terrain. Supply stations and rest houses were built and maintained for the youths who would keep watch for an approaching messenger, run out to meet him, and then run beside him long enough to exchange the message to be sent.[15] Thus, a quipu might be received, along with any interpretive words needed to accompany it, with no slowdown or delay in the process. The organization and speed of the *chasqui* system is legendary. Cieza says that "they had things so well organized that in a week the news was carried by messenger from Quito to Cuzco."[16]

Agricultural land was divided by the Inca into three parts: one was cultivated for religion; a second part was assigned to the Inca and the general support of the government; the third part was left for the food production of the ordinary citizens. Although agricultural land was limited, its productivity was high. Land designated to support the government was farmed to fill warehouses that dotted the nation. During times of war, distribution of food and other provisions was made to the soldiers. If a particular region suffered crop failure, food was redistributed from the storehouses to the afflicted area. The warehouse system made famine virtually unknown.

In addition to the storehouses, the Incas directed that housing be constructed for their troops to be able to move easily throughout the land. Cieza reports that:

> . . . so there would be adequate supplies for their men, every four leagues there were lodgings and storehouses abundantly supplied with everything to be found in these regions. Even in the uninhabited areas and deserts there had to be these lodgings and storehouses, and the representatives or stewards who lived in the capital of the provinces took great care to see that the natives kept these inns or lodgings *(tambos)* well supplied.[17]

In the capitals of the provinces were more elaborate accommodations fit for the Inca and his high-ranking officials:

> . . . throughout the extent of their provinces, there were sumptuous palaces for the Lord-Incas, and temples to the sun where the priests and the virgins—the *mamaconas*—lived, and where there were larger storehouses than the usual. Here the governor resided, and the Inca's officers, together with the *mitamaes* and other serving people.[18]

How many such inns and storehouses existed is impossible to determine, but clearly there were a great many. In one city, Cieza reports that in addition to the many storehouses where arms and fine clothing were kept as well as other articles of tribute, there were "over seven hundred houses in which the corn and other provisions for the troops patrolling the kingdom were stored."[19]

The quipucamayocs recorded the transactions affecting the inventories in all of these warehouses,[20] and they were subject to audit from time to time. For example, during one of his travels the Inca Huayna Capac

> . . . was greeted and visited by many chieftans and captains of the region, and he sent *Orejones* of his kinsmen to the coast of the Llanos and into the highlands to examine the accounts of the *quipus-camayocs,* who are the account-

> ants, as to the contents of the storehouses, and to learn how those he had named governors were conducting themselves. . . .[21]

Father Valera indicates that an item-by-item inventory count was done:

> Then they showed the collectors and the governor each thing by itself that was stored in the royal depots, such as the provisions, pepper, clothes, shoes, arms, and all other things that the Indians gave as tribute, down to the gold, silver, precious stones, and copper belonging to the King and the Sun, each item being recorded separately.[22]

And, although the quantity of quipus and quipucamayocs needed for such an accounting system throughout the empire was considerable, Incan law further required duplicate quipus at the higher administrative levels for internal control purposes:

> The law ordained that the Inca governor of the province should have a duplicate of the accounts in his own custody, to check any error on the part either of the collectors or of the payers of tribute.[23]

The Historian-Quipucamayoc

Even though quipucamayocs are often referred to in the literature as accountants, such descriptions seem altogether too limiting. There is little doubt that quipucamayocs performed many functions which we would categorize as accounting. Their efforts in recording transactions relating to tax collection (tribute) and inventory management throughout the land are clear examples. Their vital role in census-taking is perhaps also aptly described as accounting. It is easy to see their overall role in the empire within our current concept of managerial accounting.

The early Spanish chroniclers, however, used broader representations when referring to quipucamayocs. Cieza (the first Spaniard to describe and explain the quipu in writing) often referred to quipucamayocs as accountants; but he also described them as we might refer to oral historians:

> . . . they would send for the great *quipu-camayocs,* who kept the accounts and could tell the things that had taken place in the kingdom, so that they should instruct others

> of their own calling, selecting those possessing the best faculties and the greatest flow of words, to relate in orderly manner each thing that had taken place, as is done among us in ballads and lays.[24]

Father Cobo says that these officials "were like our historians, scribes, and accountants" and that they "learned with great care this way of making records and preserving historical facts."[25] In his lengthy descriptions of the disastrous meeting between the Spanish and Atahuallpa, Garcilaso relates how the Inca made a speech replying to the Spaniards and "ordered the annalists, who have charge of the knots, to take note of it and include it in their tradition."[26] In another incident, Garcilaso refers to two quipucamayocs by name as the "historians López de Gómara and Zárate."[27]

Cristóbal Vaca de Castro governed Peru from 1541 until 1544 and attempted to determine the history of the Indians and the lineage of the Incas. His questioning of the elder residents of the Cuzco area was reported to be unsatisfactory in that their usual response was only that all Incas were the descendants of Manco Capac, the first Inca. The governor's search for historical information was difficult because few quipus or quipucamayocs still existed. Upon his military victory over his half-brother, Huascar, Atahuallpa had ascended to power in 1532 and had ordered his captains to kill all the quipucamayocs they could find and burn their quipus. Only the quipucamayoc knew what was being counted on his knotted strings. Killing the recorder-interpreter and burning his quipus effectively erased the history of the past: "all was to begin anew (new world) with Ticcicapac Inca, as Atahuallpa Inca was called. . . ."[28]

Fortunately, Vaca de Castro was able to locate four very old quipu experts who managed to escape the massacres ordered by Atahuallpa's military captains Chalcochima and Quizquiz. These old quipucamayocs, found wandering in the mountains and terrorized by the tryants of the past,

> . . . had been a kind of historian, who kept account of events, and there were many and among all there was agreement in their *quipos* and accounts; they had no other task other than that of being responsible for their *quipos* and also of the history and beginnings of the Incas, of each one in particular, from the day they were born as well as the events which occurred during their respective reigns.[29]

The preceding quote suggests that there was specialization among the quipu experts. These four recorded the history of the rulers; others, for example, controlled the system of taxation.

The historical records were selective, and more than one version was kept. The common people heard one and the Inca's imperial family heard another. Not surprisingly, the "dark side of the historical picture was pretty well suppressed in the story as told to the populace, but . . . among themselves, the Incas dared to remember the devious methods whereby they came to power."[30]

Cieza indicates that there were inconsistent versions among the quipucamayocs who related history through their ballads and quipus.[31] The inconsistencies seem reasonable when we consider the selectivity that was operative. After the death of an Inca, the elders of the people decided which events that took place during his reign should be remembered. Expanding the empire, for example, was worthy of note by the quipucamayocs. Laziness, cowardliness, or excessive indulgence in vice and pleasure warranted virtual oblivion in the historical record. Such negative behavior meant that

> . . . if any mention of them was made, it was only so their names and succession should not be forgotten, but about all else they were silent, singing only of those who had been good and brave.[32]

If the Inca was deemed praiseworthy by reason of his bravery and good rule and "deserved to live forever in their memory, they would send for the great *quipu-camayocs,* who kept the accounts and could tell the things that had taken place in the kingdom."[33]

A very interesting, but not answerable, question is: how were the quipucamayocs able to adequately record historical events, as is claimed? Quipus were records of numerical data using the decimal system. The knotted strings were often of different lengths and colors, apparently to distinguish one kind of data from another. How much of a problem would it have been to make the original historical entry on the quipu in terms of numerical data? And what about the subsequent difficulty of translating that data into historical narrative? The following sweeping statement from Father Cobo raises more questions than it answers:

> And the *quipo camayos* customarily passed their knowledge on to those who entered their ranks from one generation to the next. The *quipo camayos* explained to the newcomers the events of the past that were contained in the

> ancient *quipos* as well as the things that were added to the new quipos; and in this way they explain everything that transpired in this land during all the time that the Incas governed.[34]

It is difficult to understand how the recording of historical events could be done on the quipu.

Education and Societal Roles

The route by which quipucamayocs became proficient in their vocation apparently varied. In some cases, formal schooling was the approach. Garcilaso says that, according to Father Valera, the sixth Inca (Roca) was the first ruler to open the state college (the *Yacha-huasi*) in Cuzco to educate young nobles. They were taught many subjects, including theology, law, music, philosophy, astronomy, poetry, and military science. The *amautas* (philosophers) taught them "their numbers and the art of equitably interpreting them" and "how to keep account of the years and of history by means of quipus."[35]

It is reported by Father Morúa that the first year of study involved the study of the Quechua language and the second was spent on theology, ritual, and kindred matters. Study of the quipu was begun in the third year and continued during the fourth, "learning history and many other things from the knot-records."[36] Quipu study was thus an "upper-division" level, academic discipline in the college at Cuzco.

Before the advent of the Inca Roca's college, quipu study was presumably done on an individual, tutoring basis. Some evidence for this assumption involves a quipucamayoc named Catari who "had inherited his office and the knowledge of native lore that went with it from a certain . . . keeper of the *quipus* under Mayta Capac" (the fourth Inca).[37] Also, Jiménez de la Espada indicates that quipucamayocs "were also obliged to teach their sons, keeping them well-prepared, teaching them the significance of each thing."[38] We cannot tell how many quipu-keepers the empire required from time to time, but many were necessary for accounting-related functions; Cieza reported that "all the regions had their accountants . . . and there are always in the storehouses as many accountants as there are lords, and every four months they cast up their accounts."[39] An apprentice system could have provided large numbers of quipucamayocs who were needed locally for governmental accounting. This demand surely could not have been met by the supply of graduates from the exclusive college in Cuzco. It seems reasonable to assume that throughout the four-century reign of the Incas new quipucamayocs were taught, in most instances, by quipucamayocs in practice.

The quipucamayoc had to possess great manual dexterity to cope with the knotting intricacies of the quipu. In addition to the quipu, there was another useful device available to the quipucamayoc. It is shown in Poma de Ayala's depiction of the senior accountant and treasurer[40] and, apparently, represents a type of computing box or tray. This abacus-like counting tray was used with piles of grain or pebbles to obtain totals which could then be recorded in quipus. In his analysis of this "calculator," Wassén concluded that its use by treasurers in Incan times was no doubt marked by expert skill and speed.[41]

Quipucamayocs played an important environmental role in assuring that royal hunts left viable herds of animals for the future. The Incas periodically organized a ceremonial hunt of wild animals, including deer, foxes, guanacos, vicuñas, and bear. Thousands of Indians were assembled for the hunt which succeeded by encircling, and thus capturing, the animals. Some were destroyed (e.g., bear), some sheared of their wool and set free (e.g., vicuña), and some eaten (e.g., deer). Hunting ordinarily was prohibited in the empire and the hunts were not permitted so often as to decimate animal populations. While the game was captured and sorted, a complete census "was taken, according to sex and species, and the figures were noted down by means of quipus."[42]

Most of the quipus that survive to the present time were found in graves on the Peruvian coast. Exactly what purpose there was for including them with burials is not known, but there is conjecture. Nordenskiöld analyzed sixteen such quipus and concluded that, of the numbers recorded on them, the number "seven" plays an important part, and was very likely a magical number for the Indians. He also concluded that these quipus are clever combinations of astronomical numbers that had importance to Incan astronomers or astrologers.[43] It may have been that some quipucamayocs were intimately involved in the metaphysical and astrological fabric of their society, in addition to the economic and historical.

Conclusion

It is accurate to say that the quipucamayocs were at the very center of the regulation and smooth functioning of the cradle-to-the-grave socialistic Incan society. They were there, working with the professional architects, recording the progress of the construction of the fabulous fortress of Sacsahuamán, overlooking Cuzco.[44] They were intimately and continuously occupied with the allocation of resources within the empire. They were the vital force which recorded, interpreted, and preserved the ceremonies and the history of the people. And, when the Spanish arrived, the attention of the quipucamayocs to detail and order may, as Cieza contended, have insured against the demise of the conquered Indians:

> . . . the wars, cruelties, pillaging, and tyranny of the Spaniards have been such that if these Indians had not been so accustomed to order and providence they would all have perished. . . . But being very prudent and sensible . . . they all decided that if an army of Spaniards passed through any of the provinces, unless the harm was irreparable, such as destroying the crops and robbing the houses and doing other still greater damage, as all the regions along the highway by which our men passed had their accountants, these would give out all the supplies the people could furnish so as to avoid the destruction of everything, and thus they were provided. And after they had passed through, the chieftains came together with the keepers of the quipus, and if one had expended more than another, those who had given less made up the difference, so they were all on an equal footing.[45]

Perhaps it is not too much to conclude that the Incan accounting systems and accountants were instrumental in preserving a people.

But, with rare exception, the quipus and the quipucamayocs were not to be preserved. At the end of the bloody civil war between the brothers Huascar and Atahuallpa, the latter's generals sacked Cuzco, desecrated the Tupa Inca's palace, burned his vast archive of quipus and killed quipucamayocs.[46] The Spaniards subsequently destroyed whole storerooms full of quipus to stamp out what they believed to be pagan practices, and even seized personal quipus.[47]

To completely erase the past in Incan times, both the records and the recorders had to be eliminated. Without the recorder, the quipus could not be interpreted. The accountant-historian and his data and his history were inextricably, and unfortunately, linked.

FOOTNOTES

[1] See, for example, Keister and Locke. For colored photographs of quipus, see McIntyre, p. 30.

[2] See Jacobsen and Buckmaster.

[3] Means, p. 287.
[4] Means, p. 275.
[5] von Hagen, p. 177.
[6] Means, pp. 299-300.
[7] Poma de Ayala, pp. 348, 358, 360, and 883, respectively.
[8] Gheerbrant, p. 160.
[9] Jiménez de la Espada, p. 6.
[10] Jiménez de la Espada, p. 6.
[11] Means, p. 301.
[12] von Hagen, p. 161.
[13] von Hagen, pp. 166-167.
[14] Means, p. 301.
[15] Poma de Ayala's drawing of such a courier youth is on p. 350.
[16] von Hagen, p. 63.
[17] von Hagen, p. 105.
[18] von Hagen, p. 69. *Mitamaes* were settlers or newcomers who were brought into a recently conquered province to propagate Incan culture. In exchange, an equal number of newly conquered people (also referred to as *mitamaes*) was sent to take the place of the settlers.
[19] von Hagen, p. 127.
[20] von Hagen, p. 71.
[21] von Hagen, pp. 77-78. *Orejones:* name used by the Spaniards to designate the nobles, i.e., Incas either by blood or by privilege.
[22] Means, p. 301.
[23] Means, p. 301.
[24] von Hagen, p. 187.
[25] Cobo, p. 254.
[26] Garcilaso, p. 687.
[27] Garcilaso, p. 764.
[28] Jiménez de la Espada, p. 6.
[29] Jiménez de la Espada, p. 6.
[30] Means, pp. 220-221.
[31] von Hagen, p. 231.
[32] von Hagen, p. 188.
[33] von Hagen, p. 187.
[34] Cobo, p. 254.
[35] Gheerbrant, p. 103.
[36] Means, p. 306.
[37] Means, p. 210.
[38] Jiménez de la Espada, p. 6.
[39] von Hagen, p. 175.
[40] Poma de Ayala, p. 360.
[41] Wassén, p. 200.
[42] Gheerbrant, p. 156.
[43] Nordenskiöld ("Calculations . . ."), p. 33.
[44] von Hagen, p. 143 (footnote 1) and p. 155 (footnote 5).
[45] von Hagen, pp. 174-175.
[46] McIntyre, p. 118.
[47] McIntyre, p. 31.

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USE OF KNOTTED STRING ACCOUNTING RECORDS IN OLD HAWAII AND ANCIENT CHINA

Abstract: The use of the "quipu" for accounting purposes has been primarily attributed to the Peruvian Inca culture in the days of old. Documented evidence, however, provides that early Hawaiians and ancient Chinese predated the Incan usage. Studies concentrating on the quipu as an accounting device rather than as an element in the evolution of the writing process might provide valuable contributions to the solution of the mystery surrounding this artifact. Insight into the development of mankind in the Pacific may be gained by understanding the use of the quipu in the East and West, and in Hawaii—the "meeting place" of the Pacific.

An artifact mentioned in the research of anthropology, archaeology, and ethnology is of interest to accountants, particularly accounting historians. This artifact—the knotted string record—is most commonly known in published research of these three scientific areas by the Peruvian (not Spanish) name, "quipu," "quippo," "kipu," or "khipu" which means "knots" in the Quechua (or Quichua) Indian language of the Peruvian Inca Empire.

The author became fascinated with these knotted string records while assisting Stanford University establish Latin America's first exclusively graduate school of business in Lima, Peru in 1963-64. He published an article describing the Incan use of the quipu.[1] The article which follows presents some documentation of early use of knotted string records as accounting devices in *old Hawaii* and in *ancient China.*

Hawaii

The Hawaiian use of knotted string records as accounting devices is described more recently by travelers than either the Peruvian or Chinese use. One such traveler to Hawaii, cited later in this

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article, wrote about them in his travels of 1821-29 A.D. Discovery and settlement by a native population perhaps took place in Hawaii in the eighth century A.D.[2] The Inca Empire traditionally is traced to its first "divine emperor," Manco Capac (*c.* 1200 A.D.).[3] The various Peruvian cultures conquered by the imperial Inca line of rulers, however, date back to about 8000 B.C. in Peru.[4] The history of these conquered Andean peoples, in turn, is almost entirely theoretical—their southeast Asian origin being one theory.[5]

According to Gavan Daws, an eminent scholar of Hawaiian history, two theories predominate in explaining the origin of the Polynesian culture:

> (1) Archaeological findings, together with studies of winds, currents, flora and fauna, suggest that the origin of the Polynesian culture was in the Western Pacific. Linguistic studies support this idea. The vocabulary of the Polynesian islanders is related to a widely dispersed language family extending west across Southeast Asia—as far west, indeed, as Madagascar. (2) In opposition to this general body of theory and evidence is the work of Thor Hyerdahl, who has devoted a great part of his active life to the idea that the origin of Polynesian culture is not Asian but American. Certain elements of the Polynesian flora and fauna are American in origin, and Hyerdahl's own Kon-Tiki raft expedition demonstrated that human contact was possible between the Pacific Coast of South America and Polynesia. But whether America has been a main element in the emergence of Polynesian culture, or merely subsidiary, or indeed no more than a problematic presence, remains an unresolved question.[6]

To sum up, the ancestors of both the Pre-Inca Peruvians and the Pre-Hawaii Polynesians might have used the knotted string records. Indeed, if the origin of both of these groups were in Southeast Asia, it is possible the first use might be traced to China.

Anthropologists have known for some time that knotted strings were used, for any of several possible purposes in the Marquesas Islands (near Tahiti). A few specimens of these are in the Bishop Museum in Honolulu which is famed for its collection of Polynesian artifacts. These particular museum specimens, however, are thought to have recorded genealogical data.[7] Their use as accounting devices in the Hawaiian Islands is not generally known and has not been researched until now. Unfortunately, there are no Hawaiian specimens of knotted string records in the Bishop Museum collection, but they were written about by travelers and others interested in Polynesia.

"The first Hawaiians came from south of the equator, from the Marquesas Islands, and the Society Islands of central polynesia,"[8] whose knotted string record specimens have survived. Ralph Linton served with the Marquesas Islands party of the Bayard Dominick Expedition, 1920-21, devoting his attention to material culture and archaeology. He recorded that "the use of string records seems to have been more highly developed in the Marquesas than in any other part of Polynesia [in which Hawaii, of course, is included]."[9]

Earlier (1904) another scientist and Polynesian scholar concluded that knotted string records served as mnemonic devices whose key to interpretation or translation was held by the one who knotted the strings or one of his disciples.[10] This limiting of the secret to decoding the string records is also found in the Peruvian-Inca use of the quipu by quipucamayocs *(kipu kamayog* in Quechuan) who inherited the role and underwent special training to preserve the skill.[11] What, in modern times, is the *chart of accounts* necessary for understanding, entering, and storing accounting information was memorized and entrusted to only a few select persons in both the Peruvian and Polynesian cultures in which knotted strings were used for recording transactions and storing economic and other information.

Evidence of the early Hawaiian use of knotted string records for accounting purposes is found in a journal kept (1821-29) by a representative of the London Missionary Society "deputed . . . to visit their various stations in the South Sea Islands, China, India, etc."[12] He writes:

> The tax-gatherers, though they can neither read nor write, keep very exact accounts of all the articles, of all kinds, collected from the inhabitants throughout the island. This is done principally by one man, and the *register* is nothing more than *a line of cordage* from four to five hundred fathoms in length [a fathom is six feet].

The physical characteristics of the cords permitted a recording by the tax gatherer-accountant of the dual nature of the collection: the recipient chief (district, fund) and the source (commoner-taxpayer). The cords also made possible a subsidiary classification of the collection by objects (dollars, hogs, dogs, etc.) according to this missionary who continues:

> Distinct portions of this [cordage] are allotted to the various districts, which are known one from another by knots, loops, and tufts, of different shapes, sizes, and colors. Each taxpayer in the district has his part in this string, and the number of dollars, hogs, dogs, pieces of sandalwood, quantity of taro, etc., at which he is rated is well defined by means of marks, of the above kinds, most ingeniously diversified.[13]

Prior to this 1921-29 description, a noted historian, Terrien de Lacouperie, was even more explicit (in 1885) about the nature of the knotted strings in Hawaii:

> The tax gatherers in the Island(s) of Hawaii by this means [cord records] kept accounts of all articles collected by them from the inhabitants. A rope four hundred fathoms long was used as a *revenue book.* It was divided into numerous portions corresponding to the various districts of the island; the portions were under the care of tax gatherers, who with the aid of loops, knots and tufts of different shapes, colours and sizes, were enabled to keep an accurate account of the hogs, pigs, and pieces of sandalwood, etc. at which *each person was taxed* [emphasis added].[14]

The mention of "revenue" (hogs, pigs, etc.) and "each person taxed" describes what is found in modern accounting systems.

The Peruvian knotted string record (quipu) has attracted the most attention in anthropology, and its related fields, because it is believed to be the most highly developed example. The early London missionary in Hawaii cited above, however, believed that the Hawaiian knotted string record *was about equally advanced.* In his words:

> It is probable that the famous quippos, or system of knots, whereby the records of the ancient Peruvian empire are said to have been kept, were a similar, and *perhaps not much more comprehensive,* mode of reckoning dates and associating names with historical events [emphasis added].[15]

The knotted string by its very simple nature was versatile and is known by anthropologists to have been used as a calendar, a genealogical or chronological record, etc. What is important in this research find in Hawaii is the documented, unequivocal use of the knotted string record by the *"tax gatherer-accountant."*[16]

Another quotation in this missionary's journal demonstrates that a monetary system is not necessary for the effective use of knotted string records for accounting purposes by persons who can neither read nor write:

> Our guide said that once when he came hither, being very weary and fainting with thirst, he had offered a native, who was with him, a dollar to fetch him a draught of water from the stream below. The man refused, saying, 'What good would a dollar do to *me*; for it would soon be known that I had it, and then I must give it up to the chief!' Thus were these miserable peasantry plundered by their rapacious landowners, of whom they held their little farms. Pigs, dogs, taro, and other produce, are *paid by them instead of rent,* according to mutual agreement; but the chief, in addition, can at any time extort from his tenant whatever he sees in his possession and covets; for, if refused, he may take away his lands immediately, and the poor man has no redress [emphasis added].[17]

Readers familiar with the author's hypothesis that the *concept* of double entry accounting predated writing, and therefore Pacioli, might find this early recorded Hawaiian usage of knotted string records for recording economic transactions to be of interest. The duality of the transaction—both the tax revenue *owed to* the Hawaiian chiefs who owned the land and the amount *owed by* the peasant natives strikes a familiar ring to the Pacioli plan "to arrange all the transactions in such a systematic way that one may understand each one of them at a glance, i.e., by the debit (debito—owed to) and credit (credito—owed by) method."[18]

China

The use of knotted strings for record-keeping purposes in China dates back to ancient times. Research by historians, anthropologists, and even religious scholars that far back is so fragmentary and uncertain that exact dates cannot be established for such usage—but the Chinese usage was much earlier than recorded Peruvian, and certainly Hawaiian, usage.

Two important philosophical works document the Chinese use of knotted string records. One of these is Confucian (551-479 B.C.), the other is Taoist (604? B.C.).

The description attributed to Confucius is reproduced here in French, then from another source, in English:

> "Les hommes de l'antiquité se servoient de cordes à noeuds pour donner des ordres. Ceux leur succédèrent leur substituèrent des signes ou figures."[19]
>
> "The men of antiquity used knotted cords to convey their orders; those who succeeded them substituted signs or figures for these cords."[20]

The date is more precisely pinpointed in this statement from a secondary historical source: "Before the accession of the Emperor Fo-hi (3300 B.C.) it is said that the Chinese were not acquainted with writing and used quipos."[21]

From the literature of the Taoist philosophy-religion the philosopher, Lao-tze, according to one interpreter, "is ready to . . . give up the practice of writing on bamboo slips, in favor of the prehistoric mode of keeping memoranda by knotted cords *(chieh shing),* or as they are now called with an American name, *quipu,* a method of assisting the memory by threads or various dyes knotted in special ways."[22]

The specific passage about knotted string records in the original ancient Chinese characters of the primary source is as follows:[23]

使人復結繩而用之

The interest of historians in the knotted string records often centered around the records as precursors of the development of writing and communication processes rather than as a means of record-keeping of economic matters. The following quotation, however, emphasizes their management accounting use in the administration of affairs.

> The celebrated Chinese historical work entitled *Yih-King* [attributed to Confucius] mentions that previous to the invention of writing there had existed in China a conventional mnemonic process of tying knots in cords. In the appendix of the work named, the philosopher Koung-tseu [Confucius] says: 'In great antiquity knotted cords served them for the *administration of affairs.* During the following generation the saintly man Fou-hi replaced these by writing [emphasis added].[24]

In Tibet, now an autonomous region of Southwest China, the ancient use of knotted string records is historically documented, again in connection with the "writing process" and its evolution:

> Before the reign of their famous king, *Srong btsan sgam-po* (629-698 A.D.) the Tibetans had no writing. Notched sticks and knotted cords were their *means of communication,* but we have no information on these processes, nor on their likeness or non-resemblance to similar devices in use among neighbouring nations [emphasis added].[25]

The quotation suggests the familiar contemporary description of accounting as the "language of business" and the means of communication in the administration of economic matters.

Another interesting source indicates the primitive setting in which knotted string records were adequate for recording events, including economic events. There were economic events because there was *some* private property in the predominantly feudal system in which the string records were used in the administration of affairs. For example, G. Spurgeon Medhurst "for twenty years a Missionary in China" wrote in 1905:

> A native [Su Pao] laments the degeneracy of present times: 'In ancient times men lived in caves and holes of the earth. They wore leaves for clothing. They used earthenware of the rudest description, their carts had no tires, to record events *they simply knotted a cord.* In ancient times sovereign and people all sat on mats on the floor. In ancient times the sovereign invited some one to take his place while he retired. The feudal system prevailed. Now every one of these customs is obsolete, and we all know what we have at the present day [emphasis added].'[26]

Medhurst translated Lao-tze's *Tao Teh King* (604? B.C.) as a short study in comparative religion. His translation states:

> Then, though they had boats and carts, they would have no use for them; though they had armor and weapons they would not display them. They should be *taught to return to the use of the quippo;* to be content with their food, their clothing, their dwellings, and to be happy in their traditions [emphasis added].[27]

In another translation of this same work the record-keeping use is more vividly noted; "Let people return to the spirit of the olden days when *they used knotted cords for their records . . .* [emphasis added]."[28]

East and West: Accounting, Anthropology, and Ethnology

This article has presented documentation of the knotted string record as an accounting device in old Hawaii and ancient China. Previously published research in anthropology-archaeology and ethnology has been focused mainly on the Peruvian (Inca) South American development of the quipu (knotted string record). Perhaps in future studies the eye of an accounting historian, not jaundiced by the singular pursuit of knotted strings as part of the "process of writing" evolution, can indeed help to solve the anthropological, archaeological, ethnological mystery of this artifact by focusing on its use as an accounting device. Its early use in the East (China) and the West (Peru) as well as in Hawaii where East meets West might well provide insights into the history of mankind in the Pacific. Indeed, such study might even provide clues eventually favoring onq of the two predominant theories about the origin of the Polynesian culture.

FOOTNOTES

[1] Jacobsen, pp. 221-228. See also Keister, pp. 414-416 for classic historic references to the Incan quipu.
[2] Daws, p. 7.
[3] Mason, p. 107.
[4] Mason, p. 16.
[5] Mason, pp. 19-31.
[6] Daws, p. 3.
[7] Linton, p. 443.
[8] Daws, p. 11.
[9] Linton, p. 443.
[10] von den Steinen, pp. 108-114.
[11] See, for example, Lumbreras, p. 230.
[12] Tyerman and Bennet, pp. 71-72.
[13] Tyerman and Bennet, pp. 71-72.
[14] Terrien de Lacouperie, pp. 428-429.
[15] Tyerman and Bennet, pp. 71-72.
[16] Tyerman and Bennet, pp. 71-72.
[17] Tyerman and Bennet, pp. 71-72.
[18] Geisbeek, p. 33.
[19] Saffray, pp. 404-405.
[20] du Pouget, pp. 458-460.
[21] du Pouget, pp. 458-460.
[22] Carus, pp. 186-187.
[23] Carus, pp. 186-187.
[24] Hoffman, pp. 136-140.
[25] Terrien de Lacouperie, p. 473.
[26] Medhurst, p. 129.
[27] Medhurst, p. 129.
[28] Wai-Tao and Goddard, p. 68.

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ACCOUNTING IN THE EARLY YEARS OF THE EAST INDIA COMPANY

Abstract: Although the account-books of the East India Company for the period 1600-1657 are lost, an almost complete series of minutes and other documents make the exploration of accounting in this great mercantile company possible. The present study provides a brief historical note on the rise of the English joint-stock company and then proceeds to examine (1) the general state of accounting affairs; (2) the functional organization of the accounting activity; and (3) the order and method of accounting in the East India Company.

The original charter of the East India Company was granted by Queen Elizabeth on December 31, 1600. It gave some two hundred and twenty adventurers the legal right to be "one body corporate" under the name of the *Governor and Company of Merchants of London trading into the East Indies.* It also gave them the right to corporate succession with power to admit and expel members, to receive, hold and grant property, to sue and be sued in the corporate name and use a common seal.[1] This select, corporately organized group of merchants was given monopoly rights to trade in the seas east of the Cape of Good Hope and west of the straits of Magellan. At the same time that it served as the British government's long arm in colonial activity, this great mercantile company carried on a highly profitable trade for its shareholders for over two and a half centuries.

Although the corporate enterprise—namely, the joint-stock company—emerged in England in the second half of the sixteenth century, it was not until the foundation of the East India Company that this type of organization assumed a definitive form and nomenclature. From its inception to the present—a period of nearly four centuries—the corporation has, through its many developmental changes, constituted a most challenging environment for the field of accounting. This article is limited to the exploration of account-

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ing in the early years of the East India Company. It accomplishes the task by focusing on (1) the general state of accounting affairs; (2) the functional organization of the accounting activity; and (3) the order and method of accounting. However, prior to the discussion of these issues, a brief historical note is offered which serves as background information on the rise of the English joint-stock company so well typified by the East India Company.

The English Joint-Stock Company

Before the emergence of the joint-stock company, the greater part of English trade was captured by the regulated companies. The regulated company, however, was no more a form of business organization or ownership than is a modern chamber of commerce or trade association. It did not itself engage in trading. Rather, it was an association of traders formed primarily for the control and proper conduct of a particular branch of overseas trade. Within its ranks were found the well-known forms of ownership: the sole proprietorship and the partnership. In the regulated company, each member retained his personal independence by trading on his own account or, in the parlance of that time, "on his own bottom." Expressed somewhat differently, the individual member was free to make his own investment decisions.[2]

As overseas trade developed and expanded in the sixteenth and seventeenth centuries, voyages became longer and more dangerous. Piracy was rampant. Also there were the frequent wars between maritime nations—the Portuguese, the Dutch, and the English—for the domination of the seas which resulted in heavy losses in ships and crews. On land, there were the attacks of native rulers and the violence of their subjects. Under such conditions, the ships had to be armed, and fortified trading posts built and maintained.[3] Trade to those remote lands, such as the Asian sub-continent (India), south-East Asia (Java) and the Far East, was both costly and risky. It demanded heavy capital investment. Clearly, neither the individual merchant nor even the best developed partnership could meet the challenge. To avail themselves of these new trade opportunities, merchants chose to organize themselves into a new form of enterprise, one that would be far more powerful than those represented by the regulated company.

As a result, the adventurers of Elizabethan England sought for and found the requisite form of business organization, the incorporated joint-stock company. In spite of its many relationships to old forms, the joint-stock company was a response to an entirely new range of entrepreneurial problems, two of which were capital and management.[4] In order to be able to finance the rather costly ventures into distant lands, there was a demand for large sums of capital. Unlike trade with the Continent where floating capital was quite sufficient, in long-distance commerce it became inevitable to commit considerable funds for defense and for long-lived assets. In fact, the necessity of investing in long-lived assets or "dead stock," as the term was used in those days, has come to be regarded as a decisive factor in stimulating the joint-stock enterprise.[5] Under the joint stock, it became possible to mobilize large amounts of capital from a wide circle of investors—earls and dukes, privy councilors, judges and knights, countesses and ladies of rank, widows and maiden ladies, clergyman, merchants, tradesmen and merchant strangers.[6] This wide distribution of shareholders, which has a rather modern ring to it, existed very early in the history of the East India Company trade.

Along with the demand for large amounts of capital, it was necessary to have a management that would direct the affairs of the Company on behalf of its shareholders and divide the proceeds equitably. In this way, "a whole company . . . is become [sic] as one man."[7] As specified in its charter, the East India Company was to be directed by a Governor and a Court of Committees (directors made up of twenty-four members.[8] This body had essentially a twofold function: to make business and policy decisions and to perform various tasks for the execution of the trade—preparations of the outward voyage, the discharge and unloading of goods from the incoming ships, the organization of the sales of the Company's commodities. Another court, known as the General Court, comprised all the adventurers. This court exercised supervisory control and had the power to overrule a particular recommendation of the Court of Committees. Normally, the General Court acted on the advice of the Court of Committees; however, the relationship between the two was often an uneasy one.[9]

The incorporated joint-stock company evolved rather slowly. Permanent capital, so characteristic to this form of enterprise, became a feature of the East India Company some fifty-seven years after its foundation. During the early years, the Company traded on separate and short-term capital known as terminable stock. Some terminable stocks were issued for ventures of single voyages and others, for three or four voyages.[10] When a venture was completed, the entire proceeds were divided among the shareholders on the basis of their individual investments. In some instances, part of the distribution was made in goods. The distribution of proceeds was actually liquidation of capital stock as well as distribution of profit. For this reason, it is appropriate to refer to these distributions as "divisions." A charter granted by Cromwell on October 19, 1657 wound up the practice of separate undertakings by introducing the principle of permanency of capital stock.[11] From that date on, the distributions made by the Company on permanently invested capital were part of profits and became appropriately known as dividends.

Although a precise explanation for the adoption of joint-stock organization in foreign trade is still open to discussion, there is ample evidence to suggest that such an explanation must necessarily take into consideration the following factors. During this period of history, there was first and foremost the problem of high risk in long-distance overseas trade resulting, among other things, from piracy, wars between maritime nations, and the hostility and violence of native rulers and people. Second, there was the demand for large aggregates of capital which individual entrepreneurs or even highly developed partnerships were unable or unwilling to assume. Third, there was the necessity of committing a high proportion of the capital for defense and for long-lived assets such as trading posts. Finally, there was the need for incorporation as a condition for obtaining a monopoly.[12] There are, ŋo doubt, other factors which have contributed to the rise of the English joint-stock company; I have here confined myself only to those that are most relevant to the purpose of this paper.

General State of Accounting Affairs

In conjunction with other sources, the state of accounting affairs can best be studied in the Court Minutes. Such study can provide us with considerable understanding of the conditions under which the accountants and auditors performed their duties and the usefulness of the information they produced. Here I shall try to give merely a broad picture of the state of accounting affairs.

To be sure, the East India Company did not suffer from lack of capable accountants. Thomas Stephens, the first Accountant General, was highly esteemed for his service.[13] Around 1614, he was followed by Andrew Ellam and Christopher Lanman, "accounts keepers." They were reputed to be very good accountants, though they differed greatly in their methods.[14] Unfortunately, our curiosity is not satisfied; we do not know in what ways their methods differed. There is also no indication which of the two served as chief accountant; in all likelihood they had equal standing. Ellam served until 1624, whereas Lanman continued in sole charge to 1626. Lanman was "applauded as one of the most perfect and sufficient accountants in London."[15] He was succeeded by Jeremy Sambrooke. In his early years, Sambrooke had served under Thomas Stephens, by virtue of which he was sworn a free brother of the Company.[16] He had continued his training under Lanman and was recommended by him for the position of Accountant General. Sambrooke was admitted to that position in 1626.[17] He served in that capacity for some forty years.

If the men who served as accountants were highly regarded in their vocation, the conditions under which they performed their duties were often less than desirable. In the very early years, the Accountants General did not have adequate privacy in their working place. In 1609, a proposal was made for establishing a countinghouse where the books of accounts could be kept.[18] But it was not until 1614 that Andrew Ellam's office underwent certain alteration "to free him from having his books subject to the view of every man."[19]

A common, but obviously undesirable, practice in those days was the removal of account books from the countinghouse. On several occasions when certain journals were needed, they could be found nowhere. It was thus decided that the information contained in journals were first to be entered "in the Company's books before they [journals] be lent to any man" and that "none to use them without consent of the committees."[20] A few months later, the matter had come up again and it was noted that the loss of such journals has not been without prejudice to the Company for they contained "some things known which are not fit to be published."[21] There is no indication what the "unfit" things might have been. A few years later, Ellam was ordered not to let any letters or journals be taken out of the house without special permission.[22] Account keepers, too, were ordered not to take Company books to their homes to work on, a rather prevalent practice in that period.[23]

Apart from this, accountants and auditors were often subjected to abuse from members of the Generality—shareholders who were not part of the Court of Committees. During a meeting, the Governor told of "a notable abuse and extreme insolency lately offered to the Accountants" by certain members of the Generality. These men had come into "the Auditor's office, and there by a commanding and inforcing manner required a sight of the Bantam letter [the East India Company had a trading station at Bantam in Java for its trade to South-East Asia and the Far East], which when they had got into their hands commanded Mr. Hanson [auditor] to leave the room, and, shutting him out, did not only read that letter and what others they pleased, but took extracts and copies thereof. . . ."[24] Apparently, incidents of this sort were not uncommon. Again, elsewhere we read about "the liberty some of the Generality have assumed to themselves to come into the Accountants' and Auditors' offices to peruse the Company's letters and accounts. . . ."[25]

Many in the Generality maintained that the committees (directors) were their delegates and should, therefore, keep them abreast of the Company's state of affairs. They also demanded that all matters of importance should be referred to them (General Court) for decision. The Court of Committees resented this attitude. When at a general court in 1634, it was proposed by a member of the Generality to appoint a special committee of twelve shareholders to examine the Company accounts, the idea was rejected with contempt by the governing body.[26] Following this high-handed action, the Court of Committees issued an order prohibiting any of the ordinary members from looking into the accounts and correspondence of the Company.[27] This order, along with delays in presenting the yearly balance of accounts, gave rise to suspicions concerning the reliability of accounting figures in general.

There were both praise and criticism for the accounting practiced at the East India Company. Whereas the Accountants General were praised for keeping "an exact account of every particular piece [of wares and commodities]," the bookkeepers of warehouses and other operations were criticized for not maintaining adequate records.[28] A common complaint leveled against the accounting activity at large was the lag in keeping the accounts current or "perfected" to the present. The lack of timely information may, in part, be explained by the long-distance communication lines between the home office and the East Indies. Finally, there was a certain amount of confusion in the accounts resulting from incompletely wound up voyages, each with its separate "remains" and differing lists of shareholders. But perhaps the most serious problem for accounting arose from the simultaneous running of various voyages. The Company's inability to keep the activities of these trading ventures distinct from each other was a source of confusion and embarrassment.[29]

Functional Organization of the Accounting Activity

The East India Company was acutely aware of the importance of accounting as evidenced by the regulations set forth in an eighty-two page volume entitled *The Lawes or Standing Orders of the East*

India Company.[30] Printed in 1621, the volume contains a wide range of regulations governing the affairs of the Company. These regulations specify the duties of the Company's officers, clerks and committees in charge of various operations, as well as maritime and overseas staff. They also specify the methods of performing those duties. Still other regulations provide instructions on subjects of general importance. Of particular interest to the accounting historian are the regulations concerning the organization of the accounting activity and the method of accounting employed which are discussed in the remainder of this paper.

Along with the Secretary, the Treasurer, and the Solicitor, the Accountant General was one of the more important officers of the Company. Assisted by one or more bookkeepers, the Accountant General was charged with the responsibility for maintaining "the great Bookes." In these books were "digested" or entered "the Accompts of the Yards, Factors,[31] Husband,[32] Warehouses, Wages, Imprest, Storehouses, or any other Accompts whatsoever." But these entries were made only after the said accounts were audited by the Auditors General and "signed by the severall Auditors appointed thereunto by the Court." (298) In their turn, the bookkeepers were to review the audited accounts to make sure that there was no "oversight or errour." Where an oversight or error was found, it was to be immediately "reformed." (299) Beyond this, the bookkeepers were also to "declare where any Defect is at any time, either in the Officers in not delivering up their Accompts, or in the Auditors in not Auditing the same." (304) And once a year, they were to "deliver up unto the Court at the *Fine* of June, a perfect Ballance of all Accompts in their charge." (306)

In addition to the responsibility for maintaining "the great Bookes," the Accountants General were also charged with preparation of warrants "in full payment of any provisions whatsoever;" (300) writing of "all the Company's letters, invoices, bills of lading, commissions, or instructions for the Indies, or to any other place beyond the seas;" (301) noting in a special book "all the bargains for timber, plank, masts, treenails, deals, sheathing boards;" (302) and entering "the brokes [fines] upon all men's accounts, whoseover shall not pay in their monies at the times appointed."(303)

There were two Auditors General who had their own room or place in the Company's house. At least once every quarter, they had to

> Audit up the Cashes of the two Treasurers, and the accompts of the Husband, together with the accompts of the

> Clarkes of the Storehouses in *London:* The accompts of the Clarkes of the Imprest money and wages, the accompt of the Clarke of the Cordage, of the Clarke of the Yard, of the Clarke of Beefe and Porke, of the Clarks of the Warehouses, &c. And also all the accompts from the Companies Factors in the *Indies,* or any other accompts of Factors, who make provision of Wares for the Company beyond the Seas. . . . (314)

Having done so, they were to present the audited accounts to the Auditors in the Court of Committees "to be by them approved and subscribed, before they be delivered up unto the Accomptant generall, to be entered in the Companies great Bookes." (314) Furthermore, the Auditors General were to "have care of the generall accompts, to see that all the other accompts and parcels be fairely and truly entered into them by the Booke-keepers, and that they be prepared to deliver up a perfect Ballance of all the said accompts unto the Company, by the last day of June yearely." (316)

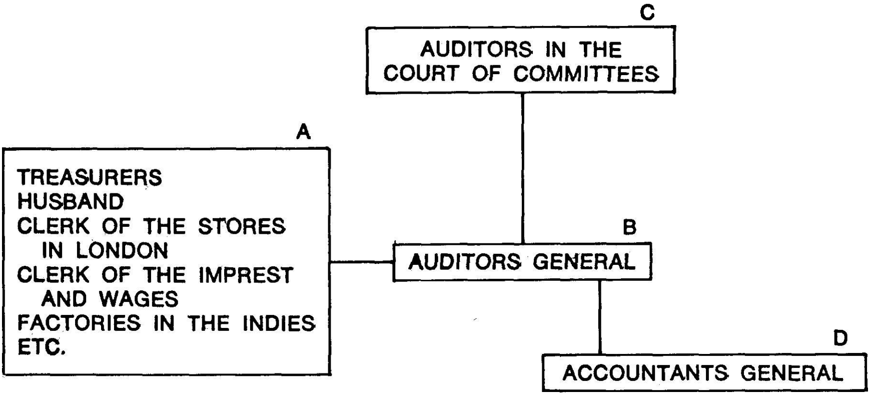
In carrying out their duties, the auditors had to watch for three things. They were required, in the first place, to "carefully cast up every parcell, and so to follow the Accomptants in all other their [sic] performance, that no miscasting or other errors may be passed for want of search." (317) Second, they were to check diligently "the issuing of the Companies materials to their buildings, the prices of provisions bought, the disbursements of charges and the like." If in any of these "there be found exorbitance, or excesse," that "it shall be brought to the consideration of the Governor, Deputy, and Committees, before the accompts be allowed." (318) Finally, because "there is now little or no trust imposed in any perticular mans accompts," the auditors must also check related "Warrants, Bils of parcels, or the accompts of other men." (319) For this purpose, the Company had drawn up a set of instructions, "Orders to bee observed for the better Vouching of sundry Accompts."[33]

Besides their duty to "subscribe to all the perticular Accompts Audited by the generall Auditors," (309) the Auditors in the Court of Committees had the charge "to examine and search out the Truth" whenever there were "occasions of difference for matter of Accompts which concerne the Company" and, having done so, "to deliver their opinions unto the Court, or else to determine and end those causes which shall be referred unto them." (307) These auditors, who were six in number, had also the authority to oversee the affairs of the Company and "to make Inquirie . . . concerning the performance of all their Lawes and standing Orders." (310) The Auditors in the Court of Committees were to be prepared to "satisfy the Company concerning the performance of their said Lawes or Orders" (2) when the occasion arose during a general court to be held once a year on the last Tuesday of May. (312) The Auditors in the Court of Committees functioned essentially as a watchdog for the Court of Committees.

The regulations of the East India Company make it amply clear that the accounting activity was basically the joint responsibility of the Auditors General and the Accountants General. The functional organization of the accounting activity, however, extended beyond these departments to include the accounting duties entrusted to certain officers, such as the Husband and the Treasurer, as well as the Clerks and the Committees in charge of various operations. These accounting duties are laid down in *The Lawes or Standing Orders of the East India Company* (published in 1621) under their respective headings. Aside from this set of regulations, instructions were issued in 1619 to Richard Mountney, Husband for the Com-

Figure 1

A Schematic Representation of the Functional Organization of the Accounting Activity


C
AUDITORS IN THE COURT OF COMMITTEES
A
TREASURERS
HUSBAND
CLERK OF THE STORES IN LONDON
CLERK OF THE IMPREST AND WAGES
FACTORIES IN THE INDIES
ETC.
B
AUDITORS GENERAL
D
ACCOUNTANTS GENERAL

pany, regarding the accounts to be kept by him.[34] Another document, "A declaration how the East India Company's books may be kept from negligent errors and examined for the finding out of wilful escapes" was issued in 1626.[35]

The Order and Method of Accounting

There are, unfortunately, no surviving account-books—journals, ledgers, etc.—from this period (1600-1657).[36] Had a complete set of books survived, it would have provided us with the clearest insight into the accounting practice of the East India Company. In the absence of such records, the historian must rely on extant Company instructions concerning the manner in which the accounts were kept. Of the various instructions available, the most important is "The order and method that the acomptants generall shall observe and performe in the managing and digesting the accompts of the company."[37] Based primarily on this source (see Illustration), an attempt is made here to reconstruct the accounting system used by the Company.

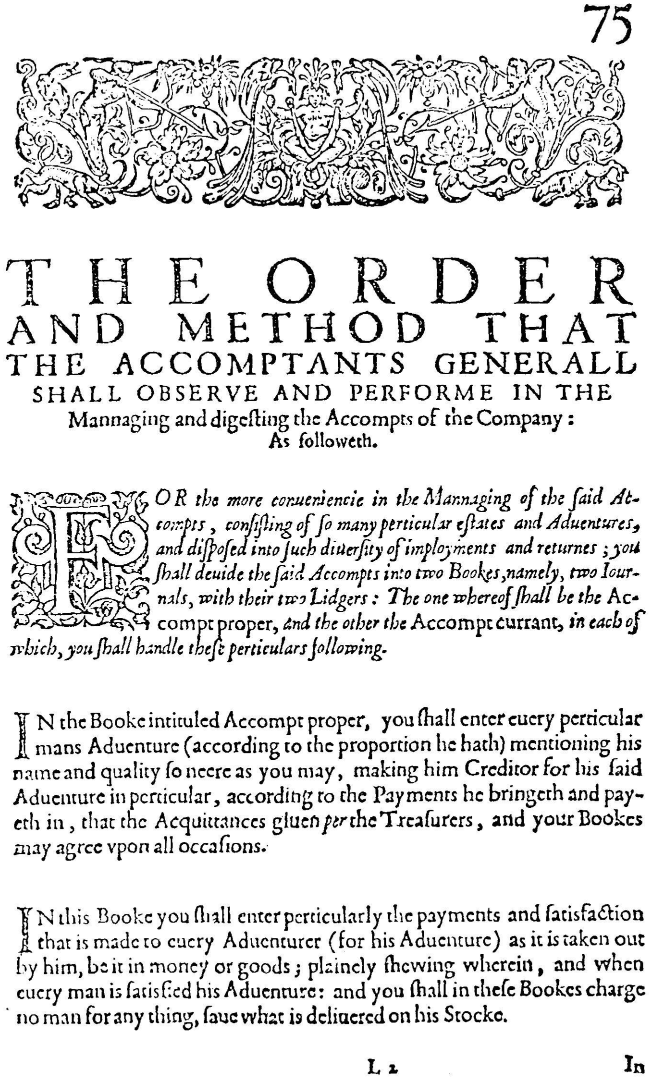
To provide "more conveniencie in the Mannaging of the said Accompts, consisting of so many perticular estates and Adventures, and disposed into such diversity of imployments and returnes," the Accountants General were to keep two sets of books, each of which to be served by a journal and a ledger. One set of books was to be designated as "Accompt proper" and the other, "Accompt currant." (75) In its turn, the Account Proper was to be divided into four parts: Adventurers' Accounts; Accounts of Employment; Factors' Accounts; and Account of Profit and Loss.

The Adventurers' Accounts were to be credited for the amounts of investment made by them, each "according to the Payments he bringeth and payeth in" so that "the Acquittances given *per* the Treasurers, and your Bookes may agree upon all occasions." Each of these accounts was to be charged with "the payments and satisfaction that is made to every Adventurer (for his Adventure) as it is taken out by him, be it in money or goods."(75)

The Account of Employment was to be charged annually with that year's "totall imployment sent to Sea, be it Marchandize, Ships, Victuals or Charges incident." This information was to be initially "contracted and digested in the Bookes of the *Accompt currant*" and then brought over "by a parcell of Ballance" to this account and entered "plainely and distinctly the Merchandize first, then the Ships with their victualling, and that yeares charge successively;

Illustration

Facsimile Page from *The Lawes or Standing Orders of the East India Company*



75

THE ORDER AND METHOD THAT THE ACCOMPTANTS GENERALL SHALL OBSERVE AND PERFORME IN THE Mannaging and digeſting the Accompts of the Company: As followeth.

FOR the more conueniencie in the Mannaging of the ſaid Accompts, conſiſting of ſo many perticular eſtates and Aduentures, and diſpoſed into ſuch diuerſity of imployments and returnes; you ſhall deuide the ſaid Accompts into two Bookes, namely, two Iournals, with their two Lidgers: The one whereof ſhall be the Accompt proper, *and the other the* Accompt currant, *in each of which, you ſhall handle theſe perticulars following.*

IN the Booke intituled Accompt proper, you ſhall enter euery perticular mans Aduenture (according to the proportion he hath) mentioning his name and quality ſo neere as you may, making him Creditor for his ſaid Aduenture in perticular, according to the Payments he bringeth and payeth in, that the Acquittances giuen *per* the Treaſurers, and your Bookes may agree vpon all occaſions.

IN this Booke you ſhall enter perticularly the payments and ſatisfaction that is made to euery Aduenturer (for his Aduenture) as it is taken out by him, be it in money or goods; plainely ſhewing wherein, and when euery man is ſatisfied his Aduenture: and you ſhall in theſe Bookes charge no man for any thing, ſaue what is deliuered on his Stocke.

L 2 In

Source: *The Lawes or Standing Orders of the East India Company,* page 75, published in 1621.

that it may readily appeare what every yeares imployment and charge amounteth unto, and wherein it consisteth." (76)

All Factors' Accounts were to show both "Sales and imployments made in and received from *India.*" "Sales" refers to English goods sold in India, while "imployments" makes reference to goods imported from India. Irrespective of the diversity, all goods arriving on a particular ship were to be entered in one account: "you shall notwithstanding in this Booke arme but one Accompt for any one Ship, but shall in that Accompt both in Journall and Lidger, successively enter every commodity, expressing his quantity and cost." (76)

In the Account Proper was also kept the Account of Profit and Loss. This account was thought of as a clearing account and, accordingly, the accountants were instructed to "cleare no Accompt or Voyage, till the same be fully accompted for, and shall also in this Accompt passe unto every man his profit or losse, as the Stocke generall shall produce." (76)

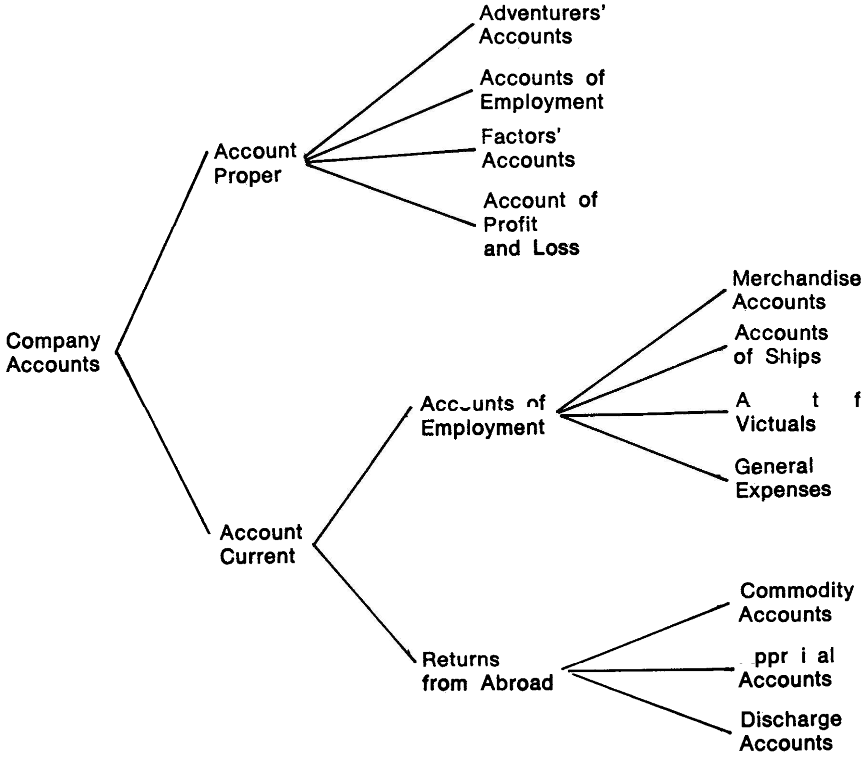
The second set of books—Account Current—was to be used exclusively for "all manner imployments and returnes, apply and perticularly." (76) It may, therefore, be viewed in two broad categories of accounts: Accounts of Employment and Returns and Returns from Abroad. The Accounts of Employment were to be divided into four parts or "Branches," namely: Merchandise Accounts; Accounts of Ships; Accounts of Victuals; and General Expenses.

In the Merchandise Accounts, the accountants were to "keepe distinct and severall Accompts in their proper kindes and denominations, not confounding many together." Once a year, the cost of all goods assigned to a voyage was to be transferred to the Account of Employment in the Account Proper. The balances in these accounts were to be carried forward to the next year. (76)

In a similar manner, the Accounts of Ships were to show the cost of ship construction, but the cost of each ship was to be recorded in a separate account. Each account of ship was to be charged "perticularly with every Materiall that is expended thereon, aswell to the Building, as furnishing, and for store, together with the Charge of wages of Workmen imployed therein, till the such Ship be fully furnished to Sea." The materials for building and furnishing ships were also to be kept "in their severall denominations and kindes, . . . that so it may readily appeare how much of every Provision is spent Yearely, and how it is spent, to the end necessary and competent proportions may alwaies bee provided, without superfluety and unnecessary Charge." (77)

Figure 2

A Classification of the Account-Books used by the East India Company during the First Half of the 17th Century.


Company Accounts
Account Proper
Adventurers' Accounts
Accounts of Employment
Factors' Accounts
Account of Profit and Loss
Account Current
Accounts of Employment
Merchandise Accounts
Accounts of Ships
A t f Victuals
General Expenses
Returns from Abroad
Commodity Accounts
ppr i al Accounts
Discharge Accounts

The Accounts of Victuals were to be kept according to the victuals' "several Denominations and kindes, and the expence of them." Then they were to be charged "on every Ship according to his proportions, that of these kindes may appeare what is yearely expended, and needfull to be provided." (77) The ships were normally victualled for the round voyage.

Last, accounts were to be kept for General Expenses, such as "Gratueties, Salary of Officers, Rents, Charges, ordinary and extraordinary, and such like." They were to be recorded in separate accounts, "every one in his proper Name and tytle, that of this quality also may appeare what is expended yearely." (77)

Annually, the accountants were to "drawe out of these Branches every yeares Imployment, to one head or Voyage, and thereon charge, first, the Marchandize agreeing with the Invoice; next the Ships, and the Victuals; and lastly that yeares generall Charge, and this in perticular, and successively." These total figures were to be transferred to the Account Proper and there entered successively in one account in the Accounts of Employment book. (77)

The Returns from Abroad account-book was established to record the "business with Factors beyond the Seas for Provision of Forraine Commodities, Officers at home for the defraying of Charges, and monyes delivered for Provisions beforehand." Here, too, the accountant is instructed to "bee carefull to keepe distinctly and plainely that one Accompt be not confounded with another." (77) The Returns from Abroad account-book was to have three divisions: Commodity Accounts; Appraisal Accounts; Discharge Accounts.

Commodities received from India were to be entered in the Commodity Accounts book "perticularly each commodity in an Accompt by it selfe." In addition, these accounts were to receive the "proper charges, and duties paid here in *England*" on those commodities. Each commodity account was also to show the proceeds from its sale. The net proceeds on the commodity was then to be transferred to its appropriate account in the Factors' Accounts book in the Account Proper. (78)

Upon their return from India, each ship was to be appraised and the results recorded in the Appraisal Accounts book. When these accounts were "fully perfected," they were to be "in one parcell" transferred to the Account Proper and "there allow the same in one totall . . . to the Voyage it belongeth." (78)

Wages and charges arising from a ship's discharge of goods were to be entered in a Discharge Accounts book. When the accounts were "perfected" they were to be "in one entire parcell" transferred to the Account Proper and "there charge the same upon the Accompt or Invoyce it belongeth; that by this means it may plainely appeare, what is got by each perticular commodity, and every Ships whole lading." (78)

In conclusion, the Accountant General was instructed to "digest and enter all Accompts into the Journall your selfe with your owne hand, For we will admit of no diversity of hands." For posting from the journal into the ledger, the Company had appointed one by the name of Jeremy Sambrooke. Sambrooke was also "to be acquainted with all other matters, to the end (That if God shall other wise dispose you) he may be able to goe forwards with the businesse, and give us a reason of the premisses." (78)

In regard to the East India Company's method of accounting, a few points of observation are in order. This description of the accounting method leaves no question in one's mind that the primary emphasis was on the recording function. Keeping an exact account of every item was the very first objective of the accountant. Pivotal to this objective was the need to identify at any time even the minutest item. Next in importance, was the objective of classification. The initial accounting data were classified in a variety of ways so as to produce further useful information on the Company's activities. A third objective was the summarization of accounting information whenever the need for it arose. Summary statements were prepared on any segment of the Company's activities as well as for its overall operations.

Conclusion

Although the first English joint-stock company appeared on the scene with the foundation of the Russia Company in 1555, it was not until the formation of the East India Company in 1600 that this new form of commercial enterprise assumed a definitive form and nomenclature. If we wanted to designate a date of origination for the English corporation, the year 1600 presents itself as a strong candidate.

Several findings emerge from this study. In regard to the functional organization of the Company's accounting activity, we become aware that unlike a modern well-integrated accounting department, the organization of the accounting activity at the East India Company during this period extended over several departments. Certain officers of the Company, such as the Husband and the Treasurer, as well as the Clerks and Committees in charge of various operations, were entrusted with accounting duties relating to their respective spheres of activity (Figure 1, box A). The Auditors General (box B) were charged with the responsibility of auditing the accounts maintained by these departments as well as those kept by the Accountants General. All accounts audited by the Auditors General were also to be reviewed by the Auditors in the Court of Committees (box C). The Accountants General (box D) had the ultimate responsibility for maintaining "the great Bookes" wherein all the accounts were eventually to be "digested."

The account-books of the Company were to be kept in accordance with the order and method adopted, and at the end of June each year "a perfect Ballance of all Accompts" was to be presented to the Court of Committees. Court Minutes indicate that drawing up annual statements showing the current status of the accounts was a perennial problem. Two reasons explain this. One was the slow communication between the Home Office and the East Indies, the other, the delays experienced by the Accountants General in obtaining the audited accounts from the various departments. Another related problem was the difficulty in keeping the ventures in various stages of completion distinct from each other. This situation caused a certain amount of confusion, embarrassment, and a lot of ill feelings between shareholders and the Court of Committees. But it is also underscored the need for operating on permanent capital. In 1657 the Company obtained a new charter from Cromwell which provided for permanency of capital.

The method of accounting used by the Company was clearly *venture accounting*. This system which dates back to at least the early fifteenth century, was implemented by various merchants and companies differently, according to their capacity and special problems. The order and method of accounting described in the *Lawes or Standing Orders of the East India Company* as well as other documents reveal that the Company was primarily interested in maintaining an accurate record of its business activities, while simultaneously calculating its profits or losses both by commodity and by voyage. It must be noted here that during this early modern period merchants and companies were more interested in calculating gross profits than net profits because what guided them in their business decisions was the gross profit margin on sales. Determination of net profit was not a significant matter. Finally, the profit or loss calculation was not made on a regular basis; rather, it was made as the need for it arose.

FOOTNOTES

[1] Birdwood, pp. 163-189.

[2] Cawston and Keane, pp. 10-12. Davis, Volume II, pp. 66-113.

[3] Furbur, pp. 38-50.

[4] Supple, p. 439.

[5] Heckscher, Volume I, pp. 388 and 408.

[6] Cooke, pp. 57-58. Chaudhuri, p. 33.

[7] As quoted by Cooke, p. 58.

[8] Birdwood, p. 169.

[9] Chaudhuri, pp. 31-33.

[10] Scott, Volume II, pp. 123-128.

[11] Scott, Volume II, pp. 122-123 and 128.

[12] Davies, p. 37.

[13] Sainsbury, 359, January 19, 1607.

[14] Sainsbury, 873, January 12, 1615.

[15] Sainsbury, 744, July 16, 1614.

[16] A term indicating membership in the Company. "Membership of the East India Company was open not only to those who secured their freedom by patrimony or apprenticeship but to any one who purchased a share in any of its voyages or stocks and paid the necessary fines." Chaudhuri, p. 33.

[17] Sainsbury, 251, February 1-3, 1626.

[18] Sainsbury, 448, July 6, 1609.

[19] Sainsbury, 682, January 19, 1614.

[20] Sainsbury, 831. December 13, 1614.

[21] Sainsbury, 1016, August 30, 1615.

[22] Sainsbury, 347, May 8-15, 1618.

[23] Sainsbury, 361, September 20-22, 1626.

[24] Sainsbury, 771, December 29, 1628.

[25] Sainsbury, 633, December 24, 1634.

[26] Sainsbury, 622, November 21, 1634.

[27] Sainsbury, 633, December 24, 1634.

[28] Sainsbury, 156, July 1, 1625.

[29] Chaudhuri, p. 221.

[30] Throughout this section, reference to a particular law or regulation is indicated by inserting the regulation number in parentheses. *The Lawes or Standing Orders of the East India Company,* pp. 1-74.

[31] "The Company had early become aware that if its trade was to be organized on favorable commercial conditions it required the creation of what later became known as the factory-system. Under this, factors or agents left behind by the ships from Europe sold their goods and made provision for the return cargo well before the arrival of the next year's shipping." Chaudhuri, p. 16.

[32] An officer of the Company whose major responsibility was to ensure that every ship was adequately provided with victuals and munitions. He also assisted the Court of Committees in purchasing "any provisions, stores, or merchandise" for the voyages. He received the iron and the casks bought by the Company and delivered them to the smiths and coopers as needed. Also he defrayed the charges incurred by the Committees for "lighterage, cranage, wharfage, rents of warehouses and petty expenses." He maintained the accounting records relating to his tasks supported by bills of parcels, receipts, etc. *Lawes,* pp. 14-15.

[33] *Lawes,* pp. 79-82.

[34] Birdwood, pp. 502-504.

[35] Sainsbury, 361, September 20-22, 1626.

[36] The original index to the ledger of the Third Joint Stock (1631-1642) has been saved and preserved in *Home Miscellaneous Series,* Vol. I, pp. 1-43. The ledger itself is lost. Accounting statements belonging to the period under study, such as the "Estimate of the First and Second Joint-Stock, 31 May 1621;" "The Success of the Second Joynt Stocke Briefly Valued, c. 1640;" and "The Estate of the Third Joint Stocke, c. 1641" are in *Home Miscellaneous Series,* Vol. 39.

[37] Throughout this section, reference to the document is made by inserting the page number in parentheses. *The Lawes or Standing Orders of the East India Company,* pp. 75-78.

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PROFESSIONAL ETHICS OF CPAS IN TAX PRACTICE: AN HISTORICAL PERSPECTIVE

Abstract: The paper traces the development of the accounting profession's own standards relating to tax practice. When appropriate, the nature and effect of government regulation on the profession's own standards are noted. It was determined that the accounting profession has been slow in developing standards for self-regulation in the area of tax practice. This may be related to two factors: (1) the existence of strong government regulation of tax practice, and (2) the diverse nature of the occupational groups engaged in tax practice.

Certified Public Accountants (CPAs) have been involved in tax practice since the passage of the corporate excise tax law in 1909. Over the years CPAs have been subject to various rules and standards prescribed by the profession. The purpose of this paper is to trace the development of the accounting profession's own standards relating to tax practice.

CPAs as professionals regulate themselves. However, in tax practice CPAs are also subject to government regulations. These regulations affect the accounting profession's own rules. The paper, however, is limited to the development of the rules and standards of the American Institute of Certified Public Accountants (AICPA) and its predecessors. When appropriate, the nature and effect of government regulation on the profession's own standards are noted. Generally, state societies and state boards follow the AICPA's lead in matters relating to ethics.

Ethics of Tax Practice—The Early Years (1900-1950)

In the years immediately after the adoption of the Federal Income Tax, both the AICPA which was then called the American Institute of Accountants (AIA) and the Federal Government were concerned with the professional behavior of CPAs engaged in tax practice. The code of ethics of the AIA was still in its formative stage, and none of the AIA's rules dealt specifically with tax practice. However, the Institute's rules relating to advertising, contingent fees, and confidential relations had implications for tax practice.

The government, in contrast, was concerned with the professional behavior in tax practice of not only CPAs, but also attorneys, and enrolled agents. In the early 1920s the Treasury department issued *Treasury Circular No. 230,* a set of regulations which was concerned with the behavior of all individuals engaged in tax practice. *Treasury Circular No. 230* has been amended many times over the years. The Institute has been concerned with the Treasury's regulations and appeared at times to react to it. CPAs in tax practice have looked to *Treasury Circular No. 230* for guidance in relation to professional behavior in tax practice.

Deficiency Act

The need for developing standards for the ethical conduct of representatives before the Federal Government was recognized by Congress in the Deficiency Appropriation Act of July 7, 1884. This Act, among other things, appropriated money for lost horses and other property in military service and gave the Secretary of the Treasury regulatory power over attorneys and other agents representing claimants. The act while requiring prospective agents to show competence and to have good moral character also empowered the Secretary to disbar or suspend agents who acted in a disreputable or fraudulent manner.[1]

Treasury Circulars Nos. 13 and 94

Treasury Circular No. 13, "Regulations Governing Attorneys and Agents Practicing Before the Treasury Department" was issued on February 6, 1886. This was amended by *Treasury Circular No. 94* issued October 14, 1890. These circulars listed procedural rules concerning such things as the use of powers of attorney and proper issuance and delivery of checks or drafts to claimants. Many of these rules and regulations were the basis for the present *Treasury Circular No. 230* which replaced the prior Circulars and today regulates practice before the IRS.

A Code of Ethics for CPAs

In 1905, Robert H. Montgomery suggested the need for a code of ethics for the accounting profession.[2] Later that year two rules of conduct were adopted by the American Association of Public Accountants (this was the original name of the organization that preceded the AIA).[3] Although the Association had dealt with the issue of advertising and disciplining of its members before 1905,[4] this was the first codification of special rules. In 1917, the AIA adopted a formal code of ethics which was taken in part from the by-laws of the predecessor American Association of Public Accountants.[5] None of these rules dealt specifically, however, with tax practice. The principal ethical problems relating to tax practice faced by the profession in the early years were: (1) advertising; (2) contingent fees; and (3) confidential relations.

Advertising In Tax Practice

In 1918, the AIA began to take some action to control advertising. A rule was adopted under which a member could be required to submit circular letters for approval before issuance, upon request of the Committee on Ethical Publicity. This rule was further refined in 1919 to require such submission.[6]

At the Institute's annual meeting in September 1921, a representative of the Commissioner of the Bureau of Internal Revenue delivered a speech detailing numerous complaints received concerning publicity and solicitation by attorneys and agents authorized to practice before the Bureau. The Commissioner's representative asserted that revisions in the recently issued *Treasury Circular No. 230* would be made shortly in reference to advertising and contingent fees. He also requested the Institute's assistance in assessment of the character, reputation, and qualifications of applicants for admission to practice before the Treasury Department.[7] The Committee on Federal Legislation of the Institute was authorized to "cooperate fully" with this request by the Treasury Department.[8]

In June 1922, an editorial in *The Journal of Accountancy* referred to an amendment to *Treasury Circular No. 230* as "Ethics by Regulation." According to its provisions, advertising was forbidden except for name, address, and a brief description of the nature of one's practice. The CPA could list only the specialization of tax practice and had to refrain from implying official connection with the government. Also proscribed was advertising implying that the CPA could obtain information of special attention not generally available to the public.[9] The Institute endorsed the Treasury's actions by adopting, on September 18, 1922, its own rule prohibiting advertising except the practice of issuing business cards.[10]

Carey suggests that "since CPAs were practicing on an equal basis with lawyers in the tax field, it was obviously important to demonstrate that the ethical standards of the accounting profession were as high as those of the Bar."[11]

In 1926, the Committee on Professional Ethics found nothing improper with listing a member's specialty on a card.[12] *Treasury Circular No. 230* had already allowed this practice. In the Bercu Case in 1948 the right of a CPA to list a tax specialty was struck down by the New York Courts. This action was formally recognized by the Institute in 1957.[13] The rule against advertising and solicitation remained in effect until, as will be discussed in a later section, the late 1970s.

Contingent Fees

A rule on contingent fees was defeated at the annual meeting of the American Association of Public Accountants in 1907.[14] Casler indicates that in 1919 the following rule on contingent fees was adopted by the Institute:

> No member shall render professional service, the anticipated fee for which shall be contingent upon his findings and results thereof. This rule shall be construed as inhibiting only services in which the accountants' findings or expert opinion might be influenced by consideration of personal financial interest.[15]

The report of the Committee on Professional Ethics on September 15, 1920, cited many instances of complaints about contingent fee arrangements in tax practice. The Committee suggested the elimination of the second sentence of the rule on contingent fees and this suggestion was adopted by the AIA.[16]

After World War I, the use of contingent fee arrangements greatly increased the number of claims pending before the Bureau of Internal Revenue.[17] Cases presented were often unfounded and without merit.[18] Many Bureau employees left their jobs to take advantage of the high potential earnings if they won a case on the contingent fee arrangement. Since the practice was so widespread, the tax administration system was overburdened; something had to be done to alleviate the problem.[19]

On April 25, 1922, a new provision concerning contingent fees was added to *Treasury Circular No. 230* which stated that the inappropriate use of contingent fees could be cause for disbarment. Such fee arrangements were generally held in disfavor and were considered the subject of possible inquiry by the Treasury Department.[20] On March 21, 1923, the Treasury Department issued an order requiring all attorneys, CPAs, and agents to submit a notice in the event of a contingent fee arrangement. This notice was to include the reason for the contingent fee as well as details concerning the fee.[21]

In 1934, the Treasury Department issued a revised *Treasury Circular No. 230* which prohibited "manifestly unreasonable fees." The revision contained a formula for calculation of a maximum contingent fee. Additionally, contingent fees were proper only where the financial status of a client meant that he could not engage an attorney or agent for his case and where extensive negotiation or litigation was apparent.[22]

In 1936, further revisions by the Treasury Department were made concerning contingent fees. A potential contingent fee arrangement could now be used even if the client could afford the customary fee. The arrangement, though, would still have to be disclosed to the Treasury Department.[23]

In October of 1936, the AIA adopted the following addition to the rule on contingent fees:

> This rule does not apply to cases such as those involving federal, state or other taxes, in which the findings are those of the tax or other similar authorities and not those of the accountant.[24]

Thus, contingent fees could be used in tax practice by CPAs; but, of course, the CPA still had to conform to *Treasury Circular No. 230.* Subsequent changes in the wording of the Institute rule on contingent fees were made in 1941; however, contingent fees could still be used in tax practice.[25]

Confidential Relationship

The confidential relationship between CPA and client is an important aspect of public accounting practice. Carey notes that as early as 1923 the Bureau's agents attempted to examine working papers of accountants.[26] In most cases, CPAs refused unless the client consented. The Bureau decided not to seek working papers unless a subpoena was obtained.[27]

The Section 340 of the Revenue Act of 1937 required that CPAs file returns disclosing information about engagements in regard to foreign corporations. It seems that the Bureau of Internal Revenue had difficulties in enforcing the income tax laws against foreign corporations and was trying to obtain assistance from other sources.[28] A *Journal of Accountancy* editorial deplored this action.[29] In 1941, the Institute made the confidential relationship between client and the CPA a formal rule of professional conduct.[30]

Treasury Circular No. 230

Treasury Circular No. 230 was originally issued on February 15, 1921. The *Circular* discussed a variety of issues. The reasons for disbarment listed in the 1884 law were expanded.[31] *Treasury Circular No. 230* has been revised many times over the years. Since our concern in this paper is self-regulation by CPAs in tax practice, in the remainder of this section we will highlight provisions, other than those previously mentioned, of early revisions to *Treasury Circular No. 230* that had possible implications to self-regulation by the profession.

Treasury Circular No. 230 was revised on April 25, 1922. Besides prohibiting advertising and placing restrictions on contingent fees, a new rule held that a CPA could be disbarred for being disbarred by another branch of government.[32] Another important change was that members of a firm could not apply for enrollment collectively but had to do so as individuals.[33]

A revision of *Treasury Circular No. 230* dated August 15, 1923, for the first time referred to CPAs. Also, additional grounds for rejection, suspension, and disbarment included conduct counter to the rules of professional ethics of the American Bar Association or American Institute of Accountants.[34] This meant that agents who were not attorneys or CPAs were subject to the same ethical rules.[35]

On February 15, 1924, *Treasury Circular No. 230* was amended. The reference to rules of ethics of the AIA was dropped. The circular now read that one could not violate the canons of ethics of the American Bar Association.[36]

On April 15, 1924, enrollees were granted the right to put the following on letterheads or cards: "Enrolled to practice before the Treasury Department." For the first time, the Treasury Department provided a list of attorneys and agents disbarred or suspended in the *Internal Revenue Bulletin*.[37] The following year a description of the cause for disbarment or suspension was added. Some thought the publication of this list would be an effective prewarning to the profession.[38]

In 1927, *Treasury Circular No. 230* was again revised. One provision required an enrollee to "advise" a client to correct errors or omissions that did not comply with the law. CPAs who lost their licenses would be disbarred. False financial statements made or certified by CPAs or agents were grounds for disbarment. Sharing fees with others who were not enrolled, not attorneys, or not accountants was forbidden.[39] Also prohibited was the distribution of solicitation type tax letters to non-client taxpayers containing some or all decisions or rules of the Treasury Department, U.S. Board of Tax Appeals, or other federal courts on tax matters.[40]

On October 1, 1936, another revision of *Treasury Circular No. 230* was issued. Reinstituted was a stipulation that enrolled agents observe the ethical standards of the accounting profession. CPAs who had obtained their certificates by waiver could not be enrolled, unless they passed the Bureau's enrollment examination and were investigated by the Bureau.[41]

While there have been subsequent changes to *Treasury Circular No. 230,* many were administrative in nature or were made to clarify the language of various provisions. One of the more significant changes was a statement made in January of 1956 that was inserted as a footnote in *Treasury Circular No. 230* which affirmed the right of CPAs to represent clients before the Treasury Department. This was an important ruling in the face of the legal profession's questioning of the accountant's right to engage in tax practice.[42] In 1966, all non-tax ethical violations were removed from the *Circular* and enforcement responsibilities were left to the concerned professions.[43] The 1966 form of the *Circular* is, for the most part, the one that exists today. Importantly, in the late 1970s the *Circular* was modified to allow advertising and solicitation.

Development of the Institute's Statements on Responsibilities in Tax Practice (1950-1977)

As of the mid-1950s, the Institute had not establshed standards in the area of tax practice. Regulation of tax practice was in essence vested in the Treasury Department via *Treasury Circular No. 230.* This section discusses the AICPA's development of standards for tax practice.

Institute Committee on Professional Ethics

In 1947, a special committee was appointed to consider whether the Institute's ethics Rule 5, relating to expression of an opinion on financial statements and acts discreditable to the profession, applied to tax practice. This Committee concluded that Rule 5 should not be expanded to include tax practice. An important factor in its recommendation was the fact that there existed no written standards in tax practice. The special committee concluded that the Institute By-laws, subsection (d) of Section 4 of Article V which discussed sanctioning members for "an act descreditable to the profession," probably could be applied to tax cases.[44]

Why were there no written self-regulating standards in tax practice at that time? One possible reason was that CPAs were not the only occupation doing tax work. Also, since the 1930s there was a good deal of controversy between accounting and legal professions over who had the right to practice in the federal taxation area. The legal profession had been challenging the accounting profession's right to perform tax services.[45] Then, too, it appears that the profession's early effort relating to professional standards appeared to concentrate on areas relating to the attest function. Finally, standards that had been developed by the Treasury Department already existed.

Committee on Tax Accounting Practice

In 1956, Marquis G. Eaton, President of the Institute suggested that the profession was silent on the subject of ethics in tax practice. He furthermore suggested that if the Institute did try to formulate a set of standards, the profession's relations with the Internal Revenue Service would improve and the CPA's public image would be enhanced.[46]

In October 1956, Eaton established a Committee on Cooperation with the Internal Revenue Service consisting of five members with Mark E. Richardson as its Chairman. The committee was to act as a liason committee and thus could only recommend action to the other Institute committees such as the Ethics Committee.[47] The new committee's purpose was to maintain liason with the IRS on various professional matters. The timing of Mr. Eaton's initiative is most interesting. It came at a time at which the legal profession's challenge to the accounting profession's right to engage in tax practice was defeated.[48]

The committee name was changed to Committee on Tax Accounting Practice after it was felt that the original name connoted responsibilities that already belonged to other AICPA committees.[49] On December 1, 1956, the Committee adopted the following objectives:

> (1) To explore the possibility of devising standards of conduct for certified public accountants in tax practice. . . .
> (2) To explore the possibility of standards of conduct and procedures for revenue agents to be announced by the

> Internal Revenue Service which would encourage taxpayer cooperation in the voluntary self-assessment and payment of federal taxes.
>
> (3) To explore the possibility of encouraging maximum cooperation between revenue agents and certified public accountants representing taxpayers with the object of minimizing the expense to the taxpayer of determining and settling his tax liabilities.[50]

On October 1, 1957, Russell C. Harrington, Commissioner of the IRS, endorsed these objectives; however, he questioned how they would be implemented. No meeting on a cooperative program took place until September 4, 1958 when Richardson met with Nelson P. Rose, General Counsel of the Treasury Department.[51] Richardson noted that many accountants approached preparation of a tax return as an "immediate adversary proceeding."[52] He suggested to Rose that a "Code of Conduct" accepted by both the profession and the IRS would be the first step to improving this situation through greater understanding with the corollary result of making the tax return as accurate as possible.[53]

Rose noted that *Treasury Circular No. 230* gave sufficient guidelines concerning rules of conduct for practitioners. But he seemed to feel the IRS did not have enough employees to properly enforce these rules of conduct.[54] Rose suggested that if an effort were made by the accounting profession to improve ethics in tax practice this would help with the administration of the tax code.[55]

In April 1959, Richardson referred to the first objective of this committee in his report to the AICPA Council.[56] He focused on clarifying the relationship of the code of ethics to tax practice.[57] Richardson was concerned that there appeared to be potential on the part of both the public and government officials to confuse the responsibilities of CPAs under the Code of Ethics when engaged in tax work.[58] For example, some of the Institute's ethical rules referred to reports on financial statements. Nowhere, however, was it indicated that these rules were not applicable to tax practice. Richardson proposed to the AICPA Council that the Committee on Professional Ethics begin a study to determine the applicability of the rules of professional conduct to tax practice.[59]

Committee on Ethics of Tax Practice

During the period 1959-1960, the Institute created a new committee that succeeded the Committee on Tax Accounting Practice and was called the Committee on Ethics of Tax Practice[60] with

Thomas J. Green as Chairman. Green, in a paper in the AICPA's files, noted that the Committee believed the rules of professional conduct at that time were not proper for application to tax practice. The committee was developing information to assist the Committee on Professional Ethics and the Federal Taxation Committee.[61]

A primary concern of the Committee on Ethics of Tax Practice was the preparation of a draft opinion on the applicability to tax practice of the rules of professional conduct. In early 1962 the Committee was working on a draft opinion that was to be submitted to the AICPA's Committee on Professional Ethics for their consideration.[62]

A significant development occurred on February 15, 1962. In a speech in Fort Worth, IRS Commissioner Mortimer M. Caplin suggested the idea of certified tax returns.[63] Although Commissioner Caplin's idea was never implemented, Gilbert Simonetti recalled that the speech caused the AICPA to move more quickly to issue an opinion on the applicability of the code of ethics to tax practice and also to develop the tax practice statements.[64]

Opinion 13 of the Committee on Professional Ethics was issued later in 1962. Dealing with the application of the Code of Professional Ethics to tax practice, Opinion 13 stated:

> It is the opinion of the Committee that the Code of Professional Ethics applies to the tax practice of members and associates except for Article 2, relating to technical standards and any other sections of the Code which relate only to examination of financial statements requiring opinions or disclaimers.
>
> The Committee is of the opinion that the statement, affidavit or signature of preparers required on tax returns neither constitutes an opinion on financial statements nor requires a disclaimer within the meaning of Article 2 of the Code.
>
> In tax practice, a member or associate must observe the same standards of truthfulness and integrity as he is required to observe in any other professional work. This does not mean, however, that a member or associate may not resolve doubt in favor of his client as long as there is reasonable support for his position.[65]

Statement on Responsibilities in Tax Practice Program

Opinion 13 alone was not enough. Thus, effective September 1, 1963, the AICPA started a new program which eventually culminated in *Statements on Responsibilities in Tax Practice.*[66]

The principal objectives of the Statements on Responsibilities in Tax Practice Program were:

1. To identify and develop minimum standards of responsibilities in tax practice and to encourage and promote their uniform application by CPAs.
2. To encourage the development of better understanding of responsibilities of the CPA by the Internal Revenue Service.
3. To foster increased public integrity and confidence in the tax system through awareness of self-imposed standards of conduct accepted by CPAs.
4. To protect CPAs against charges of misconduct resulting from misunderstanding regarding the extent of the CPA's responsibility.[67]

The purpose of the program was not to develop a separate code of ethics for tax practice but to provide guidance to CPAs so that their behavior was within the Code of Professional Ethics.[68]

Subsequent Changes and Enforcement

The Program's Introduction and Objectives were revised in 1969. Objective 4 was eliminated.

The new objectives read as follows:

(a) To identify and develop appropriate standards of responsibilities in tax practice and to promote their uniform application by CPAs;

(b) To encourage the development of increased understanding of the responsibilities of the CPA by the Treasury Department and the Internal Revenue Service and to urge their officials to promote the application of commensurate standards of responsibility by their personnel;

(c) To foster increased public compliance with and confidence in our tax system through awareness of the standards of conduct accepted by CPAs and of reciprocal measures adopted by the Treasury Department and the Internal Revenue Service.[69]

Other changes related to the statement's wording as to scope, effect, and enforcement. A sentence comparing the potential benefits of these tax statements with the benefits the *Statements on Auditing Procedure* had on auditing was eliminated. The term "advisory" was added to the section discussing the significance of the statements. This emphasized the advisory nature of the statements.[70]

The major change in the *Statements*, however, concerned the section related to referral of violations of the responsibility statements to the Committee on Professional Ethics.[71] That wording was eliminated and the following was substituted:

> Statements containing standards of responsibility which are more restrictive than those established by the Treasury Department or by the Code of Professional Ethics depend for their authority upon the general acceptability of the opinions expressed.[72]

Consequently, violations of standards set by the statements which were beyond *Treasury Circular No. 230* or the code of ethics would not be referred to the Committee on Professional Ethics for disciplinary action. Instead they rested upon their general acceptability.[73] Since the program started, ten statements have been issued on a variety of tax related issues. The last statement was issued in April, 1977. In 1982 the first two statements were withdrawn.

Changes to the Code of Professional Ethics in the 1970s that Relate to Tax Practice

During the decade of the 1970s there were three major sets of changes in the AICPA's Code of Professional Ethics. In March 1973, a major restructing of the code occurred. The newly revised code had three sections: (1) a philosophical essay; (2) rules of conduct; and (3) interpretations of the rules. The philosophical essay was included to guide practitioners. The rules were actually enforceable and contained a section on applicability which clearly indicated that the code was applicable to tax practice except where the wording indicates otherwise.

The next major changes occurred in 1978. Two of the changes that occurred that year were closely related to tax practice. The first change related to competence and technical standards. Rule 201 relating to general standards was adopted. A CPA in tax practice was required to be professionally competent, use due professional care on an engagement, adequately plan and supervise an engagement, and base conclusions or recommendations on sufficient relevant data. Additionally, a new Rule 204 relating to other technical standards was adopted. Under this rule, a CPA in tax practice would have to comply with technical standards set by a body designated by the Council of the AICPA to establish such standards. As of spring 1983, Council had not yet designated such a body. Eventually the AICPA's Federal Taxation Executive Committee is expected to be so designated and the *Statements on Responsibilities in Tax Practice* may be a basis of their early technical standards.

The second significant change in 1978 related to advertising and solicitation. In the 1977 Bates decision, the U.S. Supreme Court ruled that certain types of advertising were allowable in the legal profession.[74] In 1978, a new ethics rule was approved by the AICPA that allowed advertising that was not "false, misleading, or deceptive." However, direct uninvited solicitation of a specific individual or business was still proscribed. In 1979, however, the third major change resulted in the elimination of the uninvited solicitation rule. Thus advertising and solicitation was permissible if it was not "false, misleading, or deceptive." However, in January 1983 a new ethics rule was adopted also proscribing solicitation that utilized "coercion, overreaching, or harassing conduct."

Summary and Conclusions

The accounting profession has been slow in developing ethical standards relating to tax practice. It was not until 1962, when the Institute's Committee on Professional Ethics issued Opinion 13 that the AICPA clearly indicated that the code of ethics was applicable to tax practice. Until then, CPAs could assume that certain rules, particularly those relating to advertising, contingent fees, and confidential relations applied to tax practice.

In the mid-1960s, the Institute began its series of *Statements on Responsibilities in Tax Practice* program. However, only ten statements have been issued. Since the 1978 modification to the Rules of Conduct of the Code of Professional Ethics, the Council of the Institute has been empowered to designate a body to establish technical standards relating to tax practice that would be enforceable under the Code of Professional Ethics. As of spring 1983 Council had yet to act in this matter.

Why has the Institute been slow in developing standards for self-regulation in the area of tax practice? Perhaps the reasons may be related to two factors: (1) the existence of strong government regulation and (2) the diverse nature of the occupations engaged in tax practice.

The Treasury Department has had a long history of involvement in the regulation of tax practice. *Treasury Circulars No. 13* (1886) and *No. 94* (1890) were to an extent the basis for *Treasury Circular No. 230* which was issued in 1921 and since then has been revised many times. This *Circular* contains many detailed rules to which the CPA can look to determine appropriate professional behavior in tax practice. The existence of these regulations as well as the tax preparer rules and regulations probably reduced the pressure for self-regulating standards.

In contrast to the attest function, tax preparation and tax practice can be performed by a number of parties other than CPAs. While CPAs have attempted to develop the attest function as an area of exclusive jurisdiction, there have been periods in which CPAs have battled with the legal profession for the CPA's very right to engage in tax practice. Thus, CPAs have not attempted to claim tax as an area of exclusive jurisdiction. Consequently, it is likely that efforts to develop the attest function as an area of exclusive jurisdiction made the development of standards in that area an early priority. When, and how far the AICPA will go in the future in developing standards of tax practice is difficult to predict. The issue relates to the accounting profession's relations with the IRS and other occupations engaged in tax preparation and practice before the IRS.

FOOTNOTES

[1] 23 Stat. 258 (July 7, 1884).

[2] Montgomery, "Professional Standards: A Plea for Cooperation Among Accountants," p. 39.

[3] Casler, p. 35.

[4] Lemeron, p. 14.

[5] Carey, *The Rise: Vol. I*, p. 229.

[6] Casler, p. 82.

[7] Richardson, "A Word of Warning," pp. 279-282.

[8] Carey, *The Rise: Vol. I*, p. 220.

[9] Richardson, "Ethics by Regulation," pp. 438-439.

[10] Casler, pp. 85-86.

[11] Carey, *The Rise: Vol. I*, p. 232.

[12] Casler, p. 86.

[13] Casler, p. 93-94.

[14] Lemeron, pp. 19, 292.

[15] Casler, p. 29.

[16] *1920 Yearbook of the American Institute of Accountants*, pp. 118-119. Also, Casler, p. 30.

[17] Richardson, "Contingent Fees," pp. 357-358.

[18] Richardson, "Contingent Fees," pp. 357-358.

[19] Richardson, "Contingent Fees," p. 358.

[20] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin, 1922, Part I.,* pp. 473-474.

[21] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 2, 1923, Part I,* pp. 344-345.

[22] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 13, 1934, Part II,* pp. 604-605.

[23] Carey, "Circular No. 230," p. 174.

[24] Casler, p. 33.

[25] Casler, pp. 33-34.

[26] Carey, *The Rise, Vol. I,* p. 221.

[27] Carey, *The Rise,* p. 221.

[28] Carey, "Information Returns by Accountants," pp. 241-243.

[29] Carey, "Information Returns by Accountants," pp. 242-243.

[30] Casler, p. 69.

[31] U.S. Treasury Department, Bureau of Internal Revenue, *Cumulative Bulletin 4, January-June 1921 Income Tax Rulings Nos. 1369-1710 Inclusive,* pp. 408-414.

[32] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 1, 1922, Part I,* pp. 473-474.

[33] Richardson, "Ethics by Regulation," pp. 440-441.

[34] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 2, 1923, Part II,* pp. 372, 375.

[35] Carey, *The Rise, Vol. I,* pp. 220-221.

[36] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 3, 1924, Part I,* pp. 525-526.

[37] U.S. Treasury Department, *Internal Revenue Bulletin 3, 1924, Part I,* pp. 536-537.

[38] Manson, p. 200.

[39] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 6, 1927, Part II,* p. 398.

[40] U.S. Treasury Department, *Internal Revenue Bulletin 6, 1927, Part II,* p. 398.

[41] U.S. Treasury Department, Bureau of Internal Revenue, *Internal Revenue Bulletin 15, 1936, Part II,* p. 546.

[42] Carey, *The Rise: Vol. II,* pp. 252-253.

[43] Smith, pp. 257-258.

[44] *1947 Yearbook of the American Institute of Accountants,* pp. 103, 209, and 215.

[45] Carey, *The Rise: Vol. II,* pp. 204-257.

[46] Carey, *The Rise: Vol. II,* p. 479.

[47] Gilbert Simonetti, Jr., "Brief History of AICPA-IRS Discussions on Ethical Responsibility of Professional Tax Practitioners," p. 1 and Appendix A.

[48] Carey, *The Rise: Part II,* pp. 251-253.

[49] Simonetti, p. 2.

[50] Simonetti, pp. 2-3.

[51] Simonetti, p. 3.

[52] Simonetti, Appendix C (Written by Mark E. Richardson), p. 1.

[53] Simonetti, Appendix C (Written by Mark E. Richardson), p. 1.

[54] Simonetti, Appendix C (Written by Mark E. Richardson), p. 2.

[55] Simonetti, Appendix C (Written by Mark E. Richardson), p. 3.

[56] Simonetti, Appendix D (Written by Mark E. Richardson), p. 1.

[57] Simonetti, pp. 3-4.

[58] Simonetti, Appendix D (Written by Mark E. Richardson), pp. 1-3.

[59] Simonetti, Appendix D (Written by Mark E. Richardson), pp. 3-4.
[60] Simonetti, p. 5.
[61] Green, pp. 5, 9, and 10.
[62] Simonetti, p. 8.
[63] Caplin, p. 19.
[64] Letter from Gilbert Simonetti, Jr., to Donald T. Burns of Arthur Young & Company, December 20, 1966.
[65] *Summaries of Ethics Rulings,* Appendix B., p. 168.
[66] Wilschey, pp. 65-67.
[67] "Introduction," *Statement on Responsibilities in Tax Practice,* pp. 1-2.
[68] Wilschey, p. 66.
[69] AICPA Professional Standards, Volume 2, TX Section 101.03.
[70] Committee on Responsibilities in Tax Practice, May 26-28, 1968 meeting.
[71] Committee on Responsibilities in Tax Practice, May 26-28, 1968 meeting.
[72] AICPA Professional Standards, Volume 2, TX Section 101.10.
[73] Committee on Responsibilities in Tax Practice, May 26-28, 1968 meeting.
[74] Bates et al. v. State Bar of Arizona; 97 S. Ct. 2691 (1977).

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ANTECEDENTS OF THE INCOME TAX IN COLONIAL AMERICA

Abstract: One of the goals of the present federal income tax system is to tax individuals to the extent of their ability to pay. This concept of vertical equity did not originate in the current century. Analysis of the tax laws of the American colonies results in the conclusion that our colonial forefathers attempted to measure the faculty or ability of individuals when enacting tax legislation. This paper analyzes the varied historic forms of the test to measure the capacity to bear the burden of taxation.*

Taxation, it is said, is a hateful process in the eyes of mankind.[1] However, every government must provide for its general expenses and the cost of other public necessities by means of taxation. Recognition that the organization of society into a state necessitates taxation is found within the words of Sir Edwin Sandys, the moving spirit behind the Virginia Company: "The maintaining of the publick in all estates being of no less importance even for the benefit of the private, than the root and body of a tree are to the particular branches."[2]

Yet each social class has endeavored, amidst the clashing of greatly divergent interests, to shift the burden of taxation upon other classes. One must analyze the economic development of the American colonies in order to trace the development of taxation and the evolution of the principle of faculty or ability to pay, the principle that individuals should be required to bear the financial burden of the government in proportion to their ability to help themselves. As the economy of the colonies developed, the historic forms of the test of the faculty to bear the public burden also evolved. This paper traces the development of the attempts to measure the presumed capacity of individuals to bear this burden. A survey of the origins and evolution of colonial taxes entails a survey of the man-

*In quoting from early documents, the author has consciously elected not to note spellings which differs from present form. Such notation would have adversely affected the readability of the quotes and the paper in general due to the frequency of these differences.

ner in which the theory of justice in taxation developed as a solution to economic relations.[3] As the tax system develops and is modified, it is not only the method of collecting revenue that changes, but also the theory supporting that tax system.

In analyzing the development of theories in taxation, one should not attempt to discover well-developed theories and technical details in a primitive society and its institutions. The act of constructing an exact science where, in fact, none existed, is to pervert the course of history. New theories do not arise to replace old theories unless man has experienced the abuse generated by the application of those theories not compatible with the present social structure. Although the theories of taxation evolved slowly in colonial America, the faculty test was incorporated into the colonial tax system and has been called the ancestor of the modern income tax. Supreme Court Justice Cardozo recognized the colonial contribution to modern tax theory by saying our colonial forefathers "knew more about ways of taxing than some of their descendants seem to be willing to concede."[4]

Colonial Revenues

During the colonial period in America, the financial systems of the colonies rested upon a multitude of sources of revenue. At various times these sources included:

1. Quit-rents
2. Poll taxes
3. Property taxes
4. Fees
5. Miscellaneous taxes
6. Lotteries
7. Duties

Exhibit 1 illustrates various taxes levied in the American colonies.

By any technical definition of the term "taxes," quit-rent would not be considered a tax. The quit-rent system was an inextricable part of the feudal manorial land system transported from England to American soil. All lands discovered by English subjects were considered feudal possessions of the English Crown. The privilege of holding various territories in liege to the Crown was conferred upon a lord as a Royal prerogative. Grants of lands were made by the liege lords to the settlers. In the southern colonies, the quit-rents were designated to cover the expenses of administering each colony.[5] Among the thirteen colonies the importance of the quit-

Exhibit 1

Taxes Levied in the Colonies

	Tax									
	Poll Tax	Land	Collective Mass of Property[c]	Horses and Cattle	All Farm Stock	Stock in Trade of Merchants	Money on Hand or at Interest	Houses, etc.	Slaves	Carriages
Colony										
Southern:										
Virginia	X	X		X[b]					X	X
North Carolina	X	X							X	
South Carolina	X	X				X			X	
Georgia	X	X				X		X	X	
Middle:										
New York	X	X	X		X					
New Jersey	,	X		X				X		X
Pennsylvania	X	X		X				X	X	X
Delaware	X	X	X[a]		X[a]					
Maryland	X	X	X		X				X	
Northern:										
Vermont	X	X		X			X			
New Hampshire	X	X		X		X	X			
Massachusetts	X	X		X		X	X	X		
Rhode Island	X	X	X		X					
Connecticut	X	X		X			X	X		X

[a] Annual income from
[b] Horses only
[c] With certain exceptions

Source: Modified from Ely, *Taxation in American States and Cities*, p. 118.

rents differed sharply. In New York and New Jersey large tracts of land granted by the Dutch were free of this levy, while grants made after the acquisition of those colonies by the English bore this tax. The New England colonies did not have a firmly established system of quit-rent, owing to the Puritan's system of free tenure originally established in Plymouth Bay Colony which spread throughout Massachusetts.[6] The strength of the quit-rent system was dependent upon the economic organization of the colony and was more firmly established in the South.[7] It was not until 1776 that the quit-rent system finally ceased to exist.[8]

Another common source of revenue in the colonies was fees, licenses, and fines. While not a major source of revenue, most colonies imposed a tax on bachelors over the age of twenty-five while Virginia had a window tax. In most colonies, revenues at times were raised by means of a lottery.[9] Almost from its founding the Virginia Company employed a lottery, and even Massachusetts, the moral center of Puritanism in North America, regularly used the lottery.[10] The duties imposed were comprised of excise duties on the manufacture of liquor, export and import duties, and tonnage duties.[11] The history of the development of the property and poll taxes is in fact the history of the evolution of the faculty test in tax theory. This development will be analyzed according to geographical sections of the colonies.

The Southern Colonies

In the Southern Colonies, economic stratification was to become economic and social reality. The existence of an aristocracy based upon the amount of land held was a direct carryover from England. Under such an economic system, the tax system which evolved was comprised mainly of indirect taxes, especially custom duties, which shifted a disproportionate burden upon the lower economic classes. The land tax did not play a significant role in the tax system, because the landed aristocratics were in control of the governmental institutions and objected to bearing a large tax burden. A poll tax became increasingly impossible to retain after the introduction of negro slavery, because when the poll tax applied to slaves it became in effect a property tax to the slave holder.

During the earliest part of the colonial period, the territory that was to become the American colonies was not more than a vast wilderness. Living conditions were, at best, primitive.[12] Under these economic conditions, differences in personal status due to an inequality of possessions did not exist. In such a primitive society, each member was deemed to be approximately equal. The poll or head tax, then, represents a measure of equity in taxation, for the measure of one's ability to bear the burden of governmental expenses is based upon mere numbers.[13] The first poll tax in colonial America was enacted on August 8, 1619, a mere thirteen years after the founding of Virginia, in order to provide for the support of the civil officers, and was payable at the rate of one pound of tobacco per head.[14] This tax was necessary due to a series of changes in the system of land tenure that had taken place between 1616 and 1619, which reduced the revenues of the Virginia Company. Not only did the changes in the land tenure system reduce the colony's revenue, but it also created three distinct social classes out of a relatively primitive society.[15] It also sowed the seeds of discontent which were to surface in 1644, when poor weather resulted in a poor tobacco crop. In addition, an outbreak of Indian hostilities forced the abandonment of outlying farms, and disputes occurred between the partisans of the Cavaliers and Puritans, greatly disturbing the tobacco trade. By this time, the poll tax amounted to eighteen pounds per head, and the present economic conditions generated a class and sectional struggle for a more equitable distribution of the public burden. In 1645, in reply to this demand, the poll tax was supplemented by a property tax to last as long as hostilities with the Indians lasted.[16]

North Carolina developed the same three social classes during this time period—the gentry or large land holders, the yeomanry who owned and worked the land themselves, and white servants who were indentured for a term of service. Gradually, a fourth class developed, consisting of slaves. As in Virginia, the gentry class owned the majority of the slaves and resided in the eastern part of the state.[17] The poll tax was extremely popular with the gentry because in practice the use of the poll tax differed widely from the theory that contributions should be measured in relation to one's ability to pay; thus in an agriculture environment with land being plentiful and cheap, a land tax would fall heavier upon the land owner, the inequity of retaining the poll tax favored the gentry class who controlled the legislature.[18]

After 1700, the poll tax in Virginia carried a declining share of the expenses of government. This parallels the development in England where direct taxes became unpopular under influence of politicians in the mold of Walpole and economists such as Petty and North.[19] The general theory of taxation in vogue at the beginning of the eighteenth century in the English Empire was that land was paying its proportional share of the cost of government by means of the quit-rents and custom duties.[20] With this decline of popularity of direct taxes, the gentry successfully shifted the type of taxes in use from the poll tax to custom duties and excise taxes.[21] As a large slave class was developing in the colonies, the poll tax virtually became a property tax since the gentry were required to pay the tax on their slaves.[22]

North Carolina, however, did not witness the decline in the significance of the poll tax; its importance increased during the same period. Virginia's population was growing during this time period as was North Carolina's; however, Virginia was realizing a larger growth in the slave population and a smaller growth in yeomen and poorer white inhabitants, while North Carolina was experiencing just the reverse in population growth, resulting in declining influence of the gentry in political matters. Land was more plentiful than slaves and the gentry held a greater proportion of the land. A land tax would have placed a larger tax burden on this class. As a poll tax required a greater proportion of income from the nonproperty owners than from the gentry, there was a distinct benefit for the gentry for paying only the poll tax.[23]

Virginia assessed a faculty tax on attorneys, merchants, apothecaries, surgeons and physicians in an effort to tax those whose income was not dependent upon ownership of large tracts of land. However, this system lasted only four years before being abolished in 1790.[24] A faculty tax based upon the "estate, stock, and abilities, or the profits that any of them make off or from any public office or employment" of the citizens of South Carolina was enacted in 1701 for the same reason as Virginia's faculty tax and continued for the rest of the century. The scope of this law increased in 1703 to include "places of profits of whatever kind or nature soever."[25] In 1777, the clergy was exempted from this tax. The South Carolina faculty tax system along with that of Virginia was based upon the estimates of the tax collectors.[26]

An act of the Maryland House of Burgesses in 1641 and 1642 granted a "subsudye to the Lord Proprietor to be raised by a poll tax of fifteen pounds of tobacco per every Free man, Free woman, and every servant" over the age of twelve years.[27] It was not until 1777 that a property tax was established. During the years 1777 to 1780, Maryland levied a faculty tax on the "amount received yearly" by "every person having any public office of profit, or an annuity or stipend," and on the "clear yearly profit" of "every person practicing law or physic, every hired clerk acting without commission, every factor, agent or manager trading or using commerce in this state in order to supplement the general property."[28] This tax assessed a tax rate of one-quarter of one percent for the years 1777 and 1778, which was increased to two and one-half percent for 1779, before being abolished in 1780. The combination of both the general property tax and the faculty tax was designed to tax income of all individuals whether such income was generated by working the land or by pursuing a trade or business. Thus, measuring the faculty of all individuals in the colony of Maryland.

Georgia was the last of the original thirteen colonies to be chartered. It was not until 1732 that King George II granted the charter to the trustees of the colony; a quit-rent system was included in the charter. To support the colony the charter required quit-rent payments at the rate of four shillings per every hundred acres. The payments were to begin ten years after the granting of land.[29] Similar to the other colonies, Georgia enacted a system of commissions, fines, licenses, and other fees designed to regulate and produce revenue.[30]

In 1739, General Oglethorpe sent a letter to the trustees of the colony of Georgia complaining that no taxes were levied in order to support the militia.[31] It was not until 1755 that the first tax law was enacted. This law was a general property tax. From the beginning, the property tax was an attempt to measure an individual's ability to bear the burden of governmental expenditures as measured by the amount of visual property. The list of taxable property was quite comprehensive, including land holdings, wharves, lots in the established cities and town, and buildings and improvements on the land rated for tax purposes based upon their value. Slaves were taxed as well as the rated import value of inventories of merchants, factors, and storekeepers. "Every hundred pounds let or lying at interest" were also taxed. Individuals were required to file a sworn written declaration of their assets. Penalties were imposed for both late filings and attempts to evade the tax.[32] While the rates changed, this law served as the model for all general property tax laws in Georgia for the rest of the century. While the Maryland property tax was not as comprehensive as the Georgia law, the augmentation of the Maryland property tax by the faculty tax placed both colonies on approximately equal footing. Yet, the approaches were vastly different. The Maryland faculty tax was assessed the "amount received yearly" and the "clear yearly profit" of professional and tradesmen, while the Georgia faculty tax was a general property tax. In theory, the Maryland faculty could have been referred to as an income tax, however, in actual practice the assessment procedures employed in Maryland allowed the tax to become a classified poll tax.

A poll tax was not enacted in Georgia until 1786, when a provision of the general property tax law levied a tax on each "free mulaltoe or mustie above age 16 years."[33] This provision was included in the general property tax laws during the rest of the century. In 1778, a poll tax of five shillings on white males between 15 and 60 years of age was levied to defray the cost of fighting the "rebellion" in the northern colonies. The poll tax on white males was removed in the 1783 tax act, except for those white males over the age of 21 years not following a lawful profession, "mechanical" trade or who did not cultivate five acres of land. With the tax act of 1785, the poll tax on while males over age 21 years appeared again along with the first poll tax on free negroes.[34]

The New England Colonies

In the New England colonies, the economic and social relationships were approximately equivalent. Almost everyone owned land and the distribution of property was fairly equal. Politically, the New England colonies were democratic communities. In addition to the poll tax and custom duties, the New England colonies developed a tax upon the gross produce of land, computed according to the quantity or quality of the land, which was designed as a measure of the faculty to pay. This gross produce test evolved slowly into a real property tax and then to a general property tax. Eventually, the property tax was supplemented by a classified poll tax on various classes of town people who earned their subsistence on their labors and not on the produce of property. This classified poll tax was graduated on a subjective appraisal of the faculty of each class.

Revenues in the New England colonies were raised in the same way as in the other colonies, for the most part. In 1634, the Massachusetts Bay Colony assessed a tax on each man "according to his estate and with consideration of all other his abilityes whatsoever."[35] Yet even when the law was refined in the next year to read that "all men shall be rated for their whole abilities, wheresoever it lies," the implication is that the law deals only with real property.[36] New Plymouth Colony defined ability as more than property in 1641, and in 1643 assessors were to rate "estates and faculties" including lands, improvements, and personal abilities.[37] No mention was made of the methods to be employed in measuring the individual's faculty until 1646, when the Massachusetts Bay Colony enacted a law equating abilities with the procession of an art or trade and assessed tax rates on the basis of returns and gains expected to be earned from the practicing of such an art or trade.[38] In effect, this law taxed the gross income of the artists and tradesmen.

The value of land was calculated to be the capitalized value of its annual produce. In this law, there was a recognition of the fact that one's faculty to bear a tax was not limited to ownership of land.[39] However, the rating of the returns and gains of artists and tradesmen became a classified poll tax in actual practice. A court in 1689 set the valuation for various visible estates in New Plymouth Colony and left the practice of valuing faculties and personal abilities to be determined "at will and doome" as begun by the law of 1643.[40]

In 1692, the Province of Massachusetts was formed by the merger of the Massachusetts Bay and New Plymouth colonies. During the period from 1692 to 1780, the legislature of Massachusetts continued the process of taxing the returns and gains of individuals. In the year of the merger, the legislature of the combined colony enacted two revenue laws. The first was designed to tax all "handicraftsmen" who could be rated by their income.[41] Assessors were required to consider a "person's faculties and personal abilities" in assessing the amount an individual was required to pay under a 1697 law. Thus, the legislature fully intended to tax all income producing factors. Yet the Massachusetts legislature was uncertain that its intent was actually being carried out in the practice of assessing income, so in 1698 the legislature amended the law to include the clause "not excluding faculties." Again in 1699, the law was amended to include in the rating process any trade or faculty which is or shall be exercised by the taxpayer.[42]

No additional changes in the law occurred until 1706, when interest was included in a person's trade or faculty and the tax rate was set at one penny per pound of assessment or the rate set by any town or district.[43] In the instructions as to what to rate, the Massachusetts legislature added the words business or employment in 1738, thereby increasing the scope of the law.[44] The rate of taxation of income was for the first time included in the 1777 law. Now the assessment was to be:

> On the amount of their income from any profession, faculty, handicraft, trade, or employment; and also on the amount of all incomes and profits gained by trading by sea and on shore, and by means of advantages arising from the war and the necessities of the community.[45]

Then in 1779, the law was modified to include instructions to the assessors to consider the method and the amount in determining the rate. In reaction to apparent criticism the law also warned them to be just and reasonable. For the first time, the legislature set up a predetermined test as to what was to be considered unreasonable, when they included the phrase: "provided, they do not in any case assess such income and profits at more than five times the sum of the same amount in other kind of estate;" the next year this was increased to ten times.[46] This effectively transformed the tax into a classified poll tax. The same methods of assessing the public charges were to continue to the end of the eighteenth century, because the state Constitution adopted in 1780 required the continuation of those practices.[47]

The colonies surrounding the Massachusetts Bay and New Plymouth Colonies eventually adopted the principles of taxation developed in these two colonies. In 1640, the Colony of New Haven required that both land and personal property bear half of the tax burden.[48] Dissatisfaction with this manner of taxation was evident as early as 1645 and the Court of Assistants considered:

> How heavy the publique chardges grew, that most of them have bin expended for the publique safty and about things of common public vse, wherein all that live in the plantation have manny priveledges in it have hitherto borne noe part of these publickque chardges, wherevppon it was debated whether or noe in equety such should not be rated some way or other for time to come, so as those that have borne the whole burden hitherto may be eased; but because it was not ripe for an issue, the court referred to . . . a committee.[49]

In 1649, a faculty was levied upon laborers, tradespeople and other nonproperty owners in the same fashion that these groups were taxed in the Massachusetts Bay Colony.[50]

Connecticut enacted a tax law in 1650 taxing lands and estates where "they lie and persons were they dwell."[51] Not only was this law patterned after the Massachusetts Bay law, but the final clauses of this act were taken verbatim from the Massachusetts Bay Colony law of 1646. The development of the rating of artists and tradesmen parallels the development of such procedures and laws in Massachusetts Bay. In 1725, Connecticut enacted a law requiring attorneys to be assessed at least fifty pounds and additional sums in proportion to their practice.[52] In 1771, the colony enacted a unique law requiring all traders and shopkeepers who sell at retail to be assessed at the rate of ten percent of their prime cost of all merchandise, and traders at wholesale; tradesmen, artificers, and tavern-keepers would be taxed upon the amount of annual gains, incomes or clear profits as determined by the assessors.[53] The faculty tax in Connecticut continued until the end of the eighteenth century with the only modification made to exempt ordinary artisans.

Rhode Island developed a faculty tax later than the remainder of the New England colonies. It was not until 1673 that the Rhode Island Assembly required taxing of property and faculty for non-property holders. This was enacted because:

> This assembly, taking into consideration the great dissatisfaction and irregularity that hath been by makeinge rates or raising a common stock for public charges in this Collony in general or for any perticular towne, and the great faileableness to accomplish it and great delaies in performance, what was done, and the necessity there is for publick charge to be borne, and the justice it whould be done according to equety in estate and strength.[54]

Unique to Rhode Island was the survival of the medieval practice of having every man assess his neighbors in addition to himself. The act stated that an individual shall be required to:

> Give in writeinge what proportion of estate and strength in pertickelar he guesseth tenn of his neighbours, nameinge them pertickular, hath in estate and strength to his estate and strength.[55]

In 1695, the task of addressing the taxable rate of merchants and tradesmen was transferred to three able and honest men selected to determine the rate by estimating the individual merchant's and tradesman's yearly profit.[56] Rhode Island allowed the faculty test to lapse in the period between 1744, when this tax was still in effect, and 1754. The tax on estates and polls were the only taxes levied in 1754 and 1755,[57] and the 1766 revision of the tax laws, which served as the basis of taxation for the remainder of the eighteenth century, did not contain a faculty tax.[58]

New Hampshire relied on a faculty tax to raise revenue for a slightly longer period than Rhode Island. The faculty tax lasted from 1719 until 1794. During this time, the basic tax was modified twice, once in 1739 to speed the assessment process, and again in 1772 to limit the potential assessment to a sum of twenty pounds.[59] Neighboring Vermont was a part of New York until 1777. Once independent, Vermont patterned its laws after those of Connecticut. Vermont's first tax law in 1778 was a combination of Connecticut's 1725 tax law pertaining to a levy of at least fifty pounds on each attorney and additional amounts in proportion to their practice, and the 1771 faculty tax on tradesmen, traders and artificers. The portions of both laws used by Vermont were taken verbatim from Connecticut's laws. Only the section of the 1771 Connecticut law pertaining to the ten percent tax on the retail merchandise was not enacted in Vermont.[60] In 1791, attorneys were included among those artisans taxed in relation to their gains as assessed by the listers.[61] Merchants, traders, owners of mills, mechanics, licensed attorneys, practitioners of physic or surgery and all other persons engaged in buying, selling or exchange were required to be assessed in proportion to their gains and returns.[62]

The Middle Colonies

The Middle Colonies were not only in the middle geographically, but also in an economic and social sense. Particularly in New Netherlands there was not a significant number of large landholders as there was in North Carolina or Virginia; nor was there as equal a distribution of wealth as in the New England colonies. In the Middle Colonies, the moneyed, trading class dominated and assimilated the Dutch system of business, accounting, and taxation. Indirect taxation of trade, through an excise tax system similar to that in use in Holland, was the major source of revenue. New Netherlands (which included what is now the state of Delaware) did not impose a system of poll and property taxes similar to New England nor did it impose a system of indirect custom duties as did Virginia and North Carolina.

A faculty tax was a rarity in the Middle Colonies. During the Dutch domination of New York (New Netherlands), the tax system was composed almost entirely of excise taxes and custom duties. Under English control, in 1692, a general property tax was introduced in order to support their Majesties King William and Queen Mary. This tax was levied at a rate of one penny per pound of assessed value on all estates, real and personal.[63] The next year, a poll tax was levied by the Assembly. Each county was required to collect a specific sum; thus the rate of poll tax varied county by county. The total sum to be collected was six thousand pounds in order to raise an army to proceed to the Albany area to fight the enemies of the King in the King William War against the French and their Indian allies.[64]

In 1678, Governor Andros of Delaware first proposed a tax of one penny per pound of assessed value on every man's estate. The colony court of New Castle replied that it was nearly impossible to determine the value of each estate and collect the suggested tax. Instead, the court desired to levy a simple poll tax.[65] At the quarter sessions of the Assembly, expenses of government were to be calculated and the assessment rate determined. One-half of the tax was to be levied on the land in the three counties comprising Delaware, and the other half was to be levied as a poll tax. However, if the landowner did not reside in Delaware, the law of 1663 required that the second half of the tax become an additional assessment on the land.[66]

To finance the raising of an army to fight in the King William's War, the Assembly enacted a property tax in 1693, 1694, and 1695. The rate of tax was one penny per pound of assessed value on both real and personal property, with an accompanying poll tax of six shillings if the assessed value of all property of an individual was assessed at less than one hundred pounds.[67] A similar faculty tax was enacted in 1752 as part of a general property tax. Individuals with no visible estate would be taxed not less than 12 pounds nor more than 24 pounds.[68] Under a 1796 law, stock in trade was assessed in order to tax "merchants, tradesmen, mechanics, and manufacturers in proportion to their gains and profits."[69] However, the faculty of the listed party was measured by classifying stock in trade as personal property; thus, the faculty of those individuals not requiring stock was not measured.

The development of this faculty tax in Delaware was not the first of its type in the Middle Colonies. New Jersey had enacted a tax on tradesmen, traders, and artificers who resided within that province in 1684.[70] Typical of laws of this type, it was designed to tax profits and gains of those covered by the law. The tax was intended to supplement the general property tax by including in the tax base those individuals who would have escaped taxation by not owning land. The other middle colony, Pennsylvania, did not have a faculty tax until after the beginning of the Revolution. A classified poll tax was enacted in 1782, which included all freemen except ministers. "Manufactures and mechanics" were exempted in 1785.[71] This still was not a true faculty tax. While both the 1782 law and the 1785 law stated that all freemen subject to this tax should be rated at the discretion of the assessors, placing due regard on the profits arising from the offices, posts, trades, and occupations of the free men, in actuality the assessors were subject to legislative restrictions. As is illustrated in Exhibit 2, the poll tax had both the lower and upper limits fixed.

In relation to similar taxes in other colonies, Pennsylvania set a very low maximum tax rate. Even these rates were not imposed all

Exhibit 2

Pennsylvania's Classified Poll Tax
(Originally Enacted: 1782)
and
Amended: 1785)

Class	
Freemen of no profession or calling	50¢ to $10.00
Tradesmen	30¢ to $2.00
Tavern-keepers, shop-keepers and other retailers	50¢ to $5.00
Brokers, bankers, merchants, lawyers and physicians	$1.00 to $10.00
Persons of professions or occupations not included above	25¢ to $8.00

Exemptions: Schoolmasters, ministers of the gospels, mechanics, and manufacturers.

Source: *American State Papers, Finance*

the time; the classified poll tax rates listed were only to be imposed when the tax rate on real property was set at one percent, and the poll tax rates were to be reduced when the property tax rates were lower.[72]

Summary

One must recognize that the theories prevalent during the later colonial period did not vanish with the commencement of the Revolution. Colonial governmental institutions continued for a time after the Revolution had been won. It took some time for a distinctly American system to develop. This author has attempted to mitigate any possible exclusions due to considering 1776 as the end of the colonial period by extending this period to the end of the eighteenth century.

In analyzing the history of taxation in the American colonies, it is evident that once the colonies progressed past the primitive stage, the tax system of the various colonies evolved unique regional characteristics. This evolution was not smooth and continuous, but often yielded to the monetary demands of expediency or other countervailing considerations. Ultimately the system of taxation in each colony developed to satisfactorily balance the financial need of the colony with the reality of the economic and social relations of the colonies. Differences in the needs of the various colonies generally resulted in the assimilation of different forms of the English financial system. The political and economic organization of the colonies accounts for many differences, and the pattern of organization of each colony was dependent upon the time period in which it was originally organized.

The primitive revenues of the colonies were comprised of the feudal quit-rents, of custom duties on both imports and exports, of poll taxes, of fees and fines, and of subsidies from the colonizing powers. Later a faculty test was developed.

The evolution of the principle of faculty to pay (or vertical equity) occurred amid the clashing of divergent interests. Conflict arose out of attempts of the various social classes to shift the burden of taxation onto the other classes. The earliest form of taxation contained no idea of equity, only the concept of might. As the economic environment developed, the primary attempt to incorporate equity into the tax system was incorporated in the poll tax. During the colonial period, measures of the ability to pay progressed from existence, to expenditures, to property, and finally to product. At various times each of these measures was designed to test the individual's faculty to bear the burden of government, and his obligation for payment was based upon this test. For a time each measure was considered the most equitable and practical method to appraise the individual's faculty. As economic conditions changed a new measure was required, because if the test of faculty is not coordinated with economic and social reality, the system of taxation is doomed to failure.

FOOTNOTES

[1] Ripley, p. 9.
[2] Ripley, p. 9.
[3] Seligman, *Essays in Taxation*, p. 1.
[4] Paul, p. 35.
[5] Parker, pp. 39-40.
[6] Parker, p. 66.
[7] Ely, *Taxation in American States and Cities*, p. 112.
[8] Parker, p. 67.
[9] Ely, *Taxation in American States and Cities*, pp. 112-113.
[10] Ripley, p. 106.
[11] Ely, *Taxation in American States and Cities*, pp. 114-115.
[12] Parker, pp. 35-36.
[13] Seligman, *Essays in Taxation*, p. 10.
[14] Ripley, p. 18.

[15] Ripley, pp. 12-14.
[16] Ripley, pp. 25-26.
[17] Parker, pp. 100-101.
[18] Ripley, p. 42.
[19] Ripley, p. 25.
[20] Ripley, p. 32.
[21] Ripley, p. 36.
[22] Ripley, p. 122.
[23] Ripley, p. 122.
[24] Seligman, *The Income Tax,* p. 380.
[25] Seligman, *The Income Tax,* p. 379.
[26] Seligman, *The Income Tax,* p. 300.
[27] Ely, et al., "Sketch of Tax Legislation in Maryland," p. CXXXIX.
[28] Seligman, *The Income Tax,* p. 379.
[29] Candler, Vol. 1, p. 18.
[30] Candler, Vol. 1, pp. 33-34.
[31] Candler, Vol. 23, p. 16.
[32] Candler, Vol. 18, pp. 66-67.
[33] Candler, Vol. 19 part 1, pp. 30-32.
[34] Candler, Vol. 19 part 2, p. 527.
[35] Shurtleff, Vol. i, p. 120.
[36] Shurtleff, Vol. i, p. 166.
[37] Pulsifer, Vol. xi, p. 42.
[38] Seligman, *The Income Tax,* p. 368.
[39] Se'igman, *The Income Tax,* p. 369.
[40] Pulsifer, p. 211.
[41] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, pp. 29 and 92.
[42] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, pp. 302 and 413.
[43] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, p. 592.
[44] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, p. 934.
[45] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, p. 756.
[46] *Acts and Resolves of the Province of Massachusetts Bay, 1692 to 1780,* Vol. i, pp. 110 and 1163.
[47] Seligman, *The Income Tax,* p. 373.
[48] *Records of the Colony and Plantation of New Haven,* Vol. i, p. 40.
[49] *Records of the Colony and Plantation of New Haven,* Vol. i, p. 181.
[50] *Records of the Colony and Plantation of New Haven,* Vol. i, p. 494.

[51] *Acts and Laws of His Majesty's English Colony of Connecticut In New-England in America*, Vol. i, p. 198.

[52] *Acts Passed by the General Court or Assembly of His Majesties' Colony of Connecticut In New-England, 1725,* p. 312.

[53] *Acts and Laws of His Majesties' English Colony of Connecticut In New-England in America, 1771,* p. 258.

[54] *Acts and Laws Of His Majesty's Colony of Rhode-Island, and Providence-Plantations, In America,* p. 108.

[55] *Acts and Laws Of His Majesty's Colony of Rhode-Island, and Providence-Plantations, In America,* p. 109.

[56] *Acts and Laws Of His Majesty's Colony of Rhode-Island, and Providence-Plantations, In America,* p. 125.

[57] *Acts and Laws of the English Colonies of Rhode Island and Providence Plantations,* p. 218.

[58] Lowrie and Clark, Vol. i, p. 422.

[59] *Acts and Laws of His Majesty's Province of New Hampshire,* pp. 30 and 180.

[60] Wood, pp. 32 and 36.

[61] *Laws of Vermont,* 1791, p. 266.

[62] Wood, p. 39.

[63] *An Act for Granting to Their Majesties the Rate,* p. 1.

[64] *Anno Regni Gulielni & Mariae, REGIS & REGINAE, Angliae, Scotiae, Franciae & Hiberniae, QUINTO, and Act for Raising Six Thousand Pound,* p. 1.

[65] Daughterty, p. 14.

[66] Daughterty, pp. 16-17.

[67] Daughterty, p. 29.

[68] *Laws of the Government of New-Castle, Kent, and Sussex Upon the Delaware,* p. 234.

[69] Lowrie and Clark, Vol. i, p. 429.

[70] Leaming and Spicer, p. 187.

[71] Seligman, *The Income Tax,* p. 377.

[72] Seligman, *The Income Tax,* p. 378.

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THE BUREAU FOR PLACEMENTS

Abstract: The Bureau for Placements sought to encourage qualified college graduates to choose public accounting as a career, to place them with public accounting firms, and to remove the problem of seasonal employment. During its six years of operations, the Bureau published and distributed to college students thousands of copies of the first Institute pamphlet on careers in public accounting, and it placed 250 college graduates with public accounting firms. As a result, the Bureau started, or at least accelerated, the trend by public accounting firms toward the hiring of college graduates.

Only in recent years has it been generally accepted that entry level positions in public accounting require a college education. Certainly such acceptance would have to be placed in the post-World War II period. In the decade prior to World War II a college education had become desirable, but was not required. Larger proportions of those entering public accounting, approximately half, were college graduates, and public accounting firms were more actively recruiting college graduates. As of 1938, New York State required applicants for the CPA examination to have a college degree and also required completion of specified accounting courses. Prior to World War I, and to a large extent in the 1920s, the profession did not require a college education, and many members of the profession did not believe college training was desirable.

At the turn of the century, only five colleges or universities taught commerce and accounting courses, and very few accounting practitioners had any formal college education. Eighty years later, the baccalaureate degree with a major in accounting is generally required, and many believe a master's degree should be required.

The change in attitude by public accountants toward the employment of college graduates can be traced, in some measure, to the efforts of the Bureau for Placements of the American Institute of Accountants. In this paper we will review briefly the environment of accountancy and education prior to the establishment of the

Bureau. Then we will review the establishment and operation of the Bureau, and the contributions of the Bureau to accountancy and education.

Prior to 1920

The early efforts to organize professional accountancy in the United States sought to establish accountancy as a learned profession. Joseph E. Sterrett expressed this view in his address to the delegates to the 1904 Congress of Accountants:

> Legislation for a profession only grants opportunity. Education must be underneath and around all our legislation and organization. . . . In view of the need for proper training for men seeking admission to our ranks it is a matter of . . . interest to note the educational movement that is now underway. . . . The success of these schools [New York University and the University of Pennsylvania] means the recognition of business as a proper subject for educational effort, and to us more important still, the final step in establishing accounting as a learned profession in the United States.[1]

The American Association of Public Accountants (AAPA) and many of its members were influential in establishing schools of commerce and initiating the teaching of accounting in a collegiate environment. Numerous and complex problems were faced in the efforts to establish the "proper type" of accounting education. Accounting courses were expected to provide a study of theory as well as practice in contrast to the "procedural method" of study employed by many proprietary schools. However, relatively few full-time academics taught accounting at the collegiate level. Most of the instructors were practitioner-adjunct faculty, and they emphasized the application of procedures and techniques.

Academics resisted the acceptance of commerce as a proper area for study at the collegiate level. In fact, there were differences of opinion among accountants and businessmen as to the type of training that should be required for the practice of accounting. Some in the commercial world believed that business education was an experiential process and a long, formal education was neither necessary nor desirable. Some in the profession preferred a liberal education.[2]

The AAPA recognized that accounting education was a major problem to the profession and, through its Committee on Education, set out to devise a solution.[3] Its Committee on Education had begun to monitor accounting education in 1908. This committee noted the diversity of accounting courses and became concerned about the content of accounting education needed to successfully pass the CPA examination. It recommended, in 1919, the development of a syllabus, if not a complete accounting curriculum, directed toward preparation for the CPA examination.[4]

Recognition of Problems

Public accounting was a seasonal business concentrated between December and April which led to the employment of temporary staff. During the 1920s, public accounting firms expanded rapidly to meet the increasing demands for their services. Thus, some firms did not hold rigidly to high standards of character and performance.[5]

By the mid-twenties, the American Institute of Accountants, (Institute) recognized that accounting firms needed to secure better educated employees. Inability to offer permanent employment made it difficult to attract college-trained personnel.[6]

The Institute believed college students would be more interested in the profession if they were properly informed about the nature and importance of public accounting.[7] In response to this belief, the Institute created the Bureau for Placements. The objectives of the Bureau were (1) to encourage highly qualified college graduates to choose public accounting as a career, and (2) to remove the problem of seasonal employment. In announcing the Bureau's formation, the Institute said:

> . . . It is a concrete attempt to help in one way to solve the problem with which the profession has been faced for several years, namely, that of building a permanent staff qualified to carry on in a field where the work has increased greatly in volume and has become increasingly exacting in its demands upon those who undertake the practice of accountancy.[8]

Organization of the Bureau

In 1925, representatives of several New York City accounting firms met in joint session with the Executive Committee of the Institute and requested that the Institute participate in a program to attract college graduates to public accounting. As a result, the Executive Committee authorized the Special Committee for Placements,[9] and by March 1926, the Special Committee was established. This Special Committee was responsible for conducting the operations of the Bureau for Placements.

The Bureau was an independent, self-supporting operation.[10] Its services were available to all members of the Institute and to college students. The Bureau operated on voluntary contributions from supporting firms in its first three years. In the original plan, employers were to pay a fee of $50 per graduate: $25 at the time of request, and the remainder when the graduate was hired.[11] However, the employer fee was not required until 1928.

The Special Committee prepared a questionnaire (application) and distributed it to college students. A procedure was established to screen applicants prior to the employment process. This procedure included the following:

1. The applicant was required to provide a personal history, a detailed certified college record, a letter of endorsement from the dean of the college, a photograph, a short statement "in the applicant's own handwriting" stating the reasons for desiring training in public accounting.
2. Each application was to be examined carefully to determine if the applicant had suitable credentials.
3. Each acceptable applicant was to be personally interviewed by a member of the Institute residing near the applicant.
4. Interview reports were to be reviewed by the Special Committee, and the applicants found acceptable would then be assigned for the personal employment interview.[12]

Originally, the Institute and the Special Committee for Placements made their appeal to all college graduates. The Special Committee, primarily concerned with the quality and character of the graduate, placed little value on education in business and accounting. In fact, the Special Committee believed the accounting major to be inferior, and few were accepted in the early years of the program.[13] The March 15, 1926 *Bulletin* stated emphatically that "the essential requirement of all applicants will be a broad general education."[14]

The Special Committee established several requirements for employment. First, an accounting firm was not required to hire an applicant without a personal interview. This appears to be a response to criticism that the Bureau infringed on the employer's prerogative to select personnel. Second, the employment agreement was for a minimum of three years. An applicant, once hired, could not be discharged during this period because of the lack of business. The applicant also agreed to the three year period. Third, a minimum salary of $125 a month was established for the first year.[15]

The Bureau viewed the employment as a training process and expected it to provide a means of attracting college graduates as trainees.[16] The Institute believed that:

> The unusual opportunities offered by this training are such that to a wide-awake young man they should be at least equivalent to a postgraduate course at a school of business administration, a course which would be impossible except to a few who are able to expend the necessary time and money.
>
> . . . Needless to say these firms will be eager to make mutually satisfactory arrangements to retain promising men in their employ at the end of the training period.[17]

Career Publicity

As one of its first activities, the Special Committee prepared a brochure describing the opportunities in accountancy, requirements for the profession, and work of the accountant, and it included a short history of accountancy. The original brochure, entitled "What Will You Do After Graduation?,"[18] was prepared in 1926. As a result of suggested changes by representatives from several large universities, the brochure was completely revised during the 1926-27 operating year[19] and retitled "Accountancy is A Career for Educated Men."[20] These brochures were the first official Institute career publications.[21] In 1926, more than five thousand copies of the brochure were distributed.[22] Five thousand copies of the revised brochure were distributed during 1927.[23]

In addition to distribution of career brochures, the Special Committee had extensive correspondence with students and faculties and made numerous campus visits. In 1930, visits were made to address classes and confer with students at Carleton College, University of Chicago, Franklin and Marshall, Hamilton, Harvard, Hobart, University of Illinois, Princeton, Syracuse, Tufts, Union, William and Mary, and Yale University. The Special Committee considered its efforts to publicize career opportunities to be almost as important as its primary purpose because faculties and students better understood the work of public accounting than they had five years before.[24]

Placement Activities

The Bureau's primary function was to place promising college graduates with accounting firms. Concurrent with the activities to inform students and academics about public accounting, the Bureau made an effort to determine the number of firms which would participate and the staff positions available. Editorials in *The Journal of Accountancy* and articles in the *Bulletin* were published, and speeches were made to various groups. A questionnaire was sent to all members and associates of the Institute.[25] Representatives of 28 firms responded.

Of 120 applications approved in 1926, Table 1 shows that 32 placements were made. In 1927, requests for graduates came from 143 firms. In addition, the number of colleges cooperating with the program grew from 94 in 1926[26] to 126.[27] The Special Committee increased the rigor of its examination of student applications and revised the screening procedures.

The procedures as revised in 1927 were as follows:

> 1. A questionnaire [application] is filled out and submitted. This gives the applicant's personal history, an official transcript of his college record, and his photograph.
>
> 2. If the questionnaire is satisfactory, the Bureau communicates directly with the dean of the college and obtains a confidential report on the man's personality, character, mental ability, etc.
>
> 3. If the dean's reply is satisfactory, the applicant is interviewed by a member of the Institute located in the same or a neighboring city. The interviewer is particularly concerned with the question of whether or not the applicant is a desirable man to bring into the accounting profession and he sends in a confidential report on the interview.
>
> 4. If the report on the interview is satisfactory, the applicant's qualifications are circularized (without using his name) among members of the Institute located in the cities in which he desires to work.
>
> 5. The applicant is referred to one of the firms who report that they are interested in him and final arrangements for employment are made directly between the employing firm and the applicant.[28]

Table 1

Summary of Applicants and Placements*
1926-1931

Year	Applicants	Placements	Firms
1926	285	32	16
1927	210	47	18
1928	215	49	12
1929	240	45	**
1930	270	50	**
1931	**	27	**
Total		250	

*Determined from data in 1926-31 *Yearbooks.*
**Not available

Contributions from a few firms financed the Bureau's operations in 1926 and 1927. The Institute assumed responsibility for operating expenses in early 1928. Employing firms were charged $50 for each graduate employed.[29] Assumption of budgetary responsibility indicated that the Bureau for Placements was an accepted function of the Institute. Indeed the Council stated in 1929 that the Bureau ". . . has established itself as a permanent function of the Institute. . . . The work of this bureau will doubtless increase in usefulness and it will almost certainly be self-supporting in the near future."[30]

The Special Committee stated that:

> Perhaps the most gratifying result of the work of the bureau for placements is the rapid increase in number of Institute members who are using its facilities. This naturally pleases the members of the special committee for placements because it proves that the beliefs which motivated the inauguration of the bureau in March, 1926, were sound.[31]

Although an operating deficit was reported in the year ending August 31, 1929,[32] the Special Committee and Council expected 52 placements in the next year. A deficit was reported in 1930 although, as Table 1 shows, 50 placements were made. The Special Committee reported that a very large number of highly qualified persons were not placed "because of exceptionally quiet business conditions."[33] Despite the effects of the depression, the Committee on

Budget and Finance projected the placement of 50 graduates in its 1930-31 budget.[34]

The Bureau was unable to obtain as many positions as in prior years, and a deficit for the Bureau was reported as of June 1931. The Executive Committee resolved to support the Bureau's operations from general funds until the close of the year.[35] In September 1931, the Council reported that the Bureau of Placements had curtailed its activities as a result of an extreme decline in demand for graduates.[36] Although 27 graduates were placed in 1931, the Special Committee for Placements presented no report, and it was discontinued at the end of 1932 with no comment in the reports of the Secretary, Council, or Executive Committee.

Accomplishments of the Bureau

The profession, from its origin, had sought public recognition and status as a learned profession. Elevation to a learned profession could only come from placing the study of accounting in an academic environment and requiring its members to possess a college education. In addition, public accounting experienced growth and demand for more complex services. This resulted in a need for personnel who possessed abilities to solve complex problems and the potential to develop beyond junior levels. College graduates were the most promising sources for such qualities. Yet by the mid-twenties, less than a third of those in public accounting had a college education, and even fewer had studied business or accounting in college.

The Bureau for Placements was established to encourage college graduates to choose public accounting as a career and to eliminate dependence on part-time personnel. It was an experiment without precedent. The Bureau's mission was contrary to tradition and did not have wide-spread support.

The Special Committee for Placements developed and distributed the first accounting career brochure. Nissley said ". . . what we have in mind is rather an attempt to show precisely what the character of the work is, the difficulties that have to be faced, and to hold out the hope of final success for those who are adapted to the work."[37] Direct communications were established with college faculties and students through letters, questionnaires, and speeches.

Many believed in 1926 that the average ability of business graduates was inferior to that of other college graduates. Few of these graduates were placed during the early years of the Bureau. However, conditions in the ensuing years changed:

> . . ., students in colleges have become familiar with professional accounting work and most practitioners have gradually come to the conclusion that men obtained from the colleges are the best type of young men to engage as beginners on their staffs. During this period the quality of the students in the collegiate schools of business also has improved substantially. . . ., we are now looking more and more to the collegiate schools of business for our raw material. In fact, it is probably safe to say that we now look to that source almost exclusively.[38]

The Bureau brought about a trend toward the hiring of college graduates. Cary noted that a number of those hired through the Bureau became partners in the accounting firms, and it became recognized that college graduates were more promising junior accountants than high-school graduates. After World War II, accounting firms began college campus recruiting programs, and college graduates became the desired source of new blood for the profession.[39] According to Carey, "if the bureau for placements did not single-handedly start this trend, it certainly dramatized and accelerated it."[40]

FOOTNOTES

[1] Sterrett, pp. 32-33.
[2] Previts and Merino, p. 149.
[3] Ame,ican Association of Public Accountants, p. 78.
[4] American Institute of Accountants, *1919 Yearbook,* p. 106.
[5] Carey, p. 150.
[6] American Institute of Accountants, "A Bureau for Placements," pp. 1-2.
[7] American Institute of Accountants, "A Bureau for Placements," p. 1.
[8] American Institute of Accountants, "A Bureau for Placements," p. 2.
[9] American Institute of Accountants, *1926 Yearbook,* p. 160.
[10] American Institute of Accountants, *1926 Yearbook,* p. 127.
[11] American Institute of Accountants, "A Bureau for Placements," pp. 1-2.
[12] American Institute of Accountants, *1926 Yearbook,* p. 185.
[13] Warren W. Nissley, "Selection of Personnel," p. 102.
[14] American Institute of Accountants, "Special Committee for Placements," p. 1.
[15] American Institute of Accountants, *1926 Yearbook,* p. 187.
[16] "What Will You Do After Graduation?," p. 290.
[17] "What Will You Do After Graduation?," p. 290.
[18] "What Will You Do After Graduation?," p. 290.
[19] W. W. Nissley, "Progress of the Bureau for Placements," pp. 38-39.
[20] "Education and Schools," p. 54.
[21] "Warren W. Nissley," p. 188.
[22] American Institute of Accountants, *1926 Yearbook,* p. 185.

[23] American Institute of Accountants, *1927 Yearbook,* p. 172.
[24] American Institute of Accountants, *1930 Yearbook,* pp. 176-177.
[25] American Institute of Accountants, "Special Committee for Placements," p. 2.
[26] American Institute of Accountants, *1927 Yearbook,* p. 172.
[27] American Institute of Accountants, *1928 Yearbook,* p. 178.
[28] Nissley, "Progress of the Bureau for Placements," pp. 39-40.
[29] American Institute of Accountants, *1928 Yearbook,* pp. 155-156.
[30] American Institute of Accountants, *1929 Yearbook,* p. 152.
[31] American Institute of Accountants, *1929 Yearbook,* p. 185.
[32] American Institute of Accountants, *1929 Yearbook,* p. 146.
[33] American Institute of Accountants, *1930 Yearbook,* p. 176.
[34] American Institute of Accountants, *1930 Yearbook,* p. 165.
[35] American Institute of Accountants, *1931 Yearbook,* p. 216.
[36] American Institute of Accountants, *1931 Yearbook,* p. 212.
[37] Warren W. Nissley, "A Bureau for Placing Junior Accountants," p. 67.
[38] Nissley, "Selection of Personnel," p. 102.
[39] Carey, p. 277.
[40] Carey, p. 278.

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VEDIC PARTNERSHIP RULES

Abstract: The law writers of ancient India (around 700 B.C.) devised, in a period of flourishing trade, rules for the administration of partnerships, formed as a means of combining capital and skills of individual entrepreneurs. These rules are indicative of the concern of the writers with partnership economics and equity—concepts which form an important part of present day partnership law.

The earliest systematic references to partnership arrangements and rules in ancient Sanskrit appear in the Smriti ("recollections") literature which probably originated around 700 B.C., reaching their present form some 1,000 years later.[1] The Smritis, which were essentially codifications of custom, tradition and practice, constituted the law books of ancient India.[2] The ordinances contained therein, however, owed much of their credence to being regarded also as deriving their legal force from the Divine word as depicted in the hymns of the Vedas, which form the genesis of Indian social and religious thought. The chronological sequence of the Smritis cannot be conclusively determined thereby precluding an evolutionary study of partnership law. However, a sequence suggested by Jolly[3] appears to be widely accepted:

Manu Smriti	2nd or 3rd century A.D.
Yajnavalkya Smriti	4th century A.D.
Narada Smriti	6th century A.D.
Brhaspati and Katyayana Smritis	7th century A.D.

This paper uses Jha's[4] collection of translated excerpts from the Smriti literature relating to partnership law. These excerpts include chapter and paragraph references to the original Sanskrit texts. Jha uses two digests (written in Sanskrit), the *Smritichandrika* and the *Vivadaranatkara,* in his interpreted translation into English which, in the main, is found to agree with other authoritative and more literal translations (for example, see Buhler, Derrett (1975), Dutt, Jolly and Kane (1933)).

Priestly Associations

Manu provided the earliest rules governing partnership type arrangements in the context of priests jointly officiating at a sacrifice:[5]

> Among a number of priests officiating at a sacrifice, the chief men shall receive half of the fee; those belonging to the second grade shall receive half of that; those of the third grade, the third part of that; and those of the fourth grade, the fourth part. (Manu, 8.210).
>
> Where specific fees have been prescribed for particular parts of the sacrifice, the priest who performs the particular part shall receive the fee specifically prescribed for that part. (Manu, 8.208).
>
> If a priest appointed to officiate at a sacrifice abandons his work, his associates shall pay him out of the fee only such shares as may be in keeping with the work actually done by him. (Manu, 8.206).
>
> If a priest abandons his work after the fees have been paid, he should receive his full share; the work left unfinished should be got done by another. (Manu, 207).

Manu's sharing rule is somewhat ambiguous. Kane[6] understands the rule to imply that the total fee, usually of cows, was to be given to the chief priests to be shared out in such a way that the second, third and fourth grade of priests received, respectively, one-half, one-third and one-fourth of what the chief priests received. Thus a fee of a hundred cows would be shared between the four ranks of priests: forty-eight, twenty-four, sixteen and twelve cows respectively.[7] The value of such a rigid rule would presumably have lain in the avoidance of indecorous conflict among men of god. After specific fees had been allocated, the balance of the fees was to be shared equally by the priests.[8] Manu's exposition of a concept of sharing the fruits of joint labour at a time when joint enterprise was unknown in Indian law[9] is of significance because, although clearly not intended to apply to commercial partnerships, it laid the foundations of partnership law as expounded by later writers.

Trading Partnerships and Profit Sharing

A basic definition of commercial partnership was provided by Narada:

> When traders and others carry on business jointly it is called a partnership *(sambhuya samutthanam).* (Narada, 3.1).

Here, and in subsequent excerpts, the business (profit) motive will be seen to have been explicit in the Smriti partnership. This contrasts with the Roman Societas which included any joint undertaking formed whether or not for commercial reasons.[10] The profit-seeking objective was emphasised in a later passage by Narada where he indicated the importance of capital and the desirability of each partner having a financial stake in the enterprise:

> When several partners are jointly carying on business for the purpose of making profits, the supplying of capital forms the basis of such business; each should therefore contribute his proper share towards the capital. (Narada, 3.2).

(Since the contributed funds form the *adhara,* the substratum, or the sustaining power, of the partnership each member would pay in accordance with how he wishes to stand in the partnership.)

Capital appears to have been considered the most, if not the only, significant input as it was the sole determinant of the profit sharing ratio:

> The expenses, the loss and the profit of all the partners are either equal or more or less, in accordance with the share of capital contributed by each. (Narada, 3.3).
>
> In the case of persons investing gold, grains, liquids or other things, the profit of the partners shall be in accordance with the share of capital contributed by each. (Brhaspati, 14.4).
>
> When a number of tradesmen carry on business jointly for the purpose of making profit, the profit or loss of each shall be either in proportion to the share of capital contributed by each, or as has been agreed upon among themselves. (Yajnavalkya, 2.259).

In the above passages the writers did not explicitly allow for unequal profit sharing on the basis of non-capital inputs, such as effort and skill, although Yajnavalkya appears to have considered this possibility. Brhaspati acknowledged labour as an input but made the curious suggestion that this should be contributed in proportion to the partners' capital introductions:

> An an equal, larger or smaller share of the capital has been contributed by a partner, in the same proportion he shall pay the expenses, do the work and take the profit. Brhaspati, 14.3).

Only Katyayana considered the possibility and the problems of a partnership being formed without an express profit sharing agreement:[11]

> This is the rule of decision as regards all, who engage in a joint undertaking without previously defining their shares such as merchants, husbandmen, robbers or artisans. (Katyayana, 637).

The rule being referred to here is possibly that for profit sharing mentioned in preceding passages by Katyayana in the context of artisans, adventurers (plundering in enemy territory with their King's consent) and dancers.[12] The formula suggested in those passages involved determining profit shares in accordance with four levels of competence, responsibility or skill contributed to the joint undertaking; thus, four shares each were to be paid to individuals of the highest level and three, two, and one share each (respectively) were to be awarded to participants at the second, third, and fourth levels.[13]

The above device does seem to acknowledge, although in a simplistic way, that rewards should somehow be related to non-capital inputs. It is also possible that Katyayana intended these rules to apply only to partnerships associations which were labour intensive. The Societas arrangement, on the other hand, clearly permitted contributions by partners of "capital, skill or labour"[14] and shares of profit and losses were not necessarily based exclusively on capital contributions.[15]

Rights, Liabilities and Third Party Relationships

The rights and liabilities of partners *inter se* were specfied by the writers with some consensus:

> When any one partner, acting without the assent of other partners, or against their express instructions, injures the joint property, through negligence, that loss has to be made good to all the partners by that same man. (Brhaspati, 14.9).

> Each partner is responsible for any loss incurred through his want of care, or through his acting against the instruc-

> tions of, or without authorisation from, all the other partners. (Narada, 3.5).
>
> When a loss has been caused by any one partner having acted through negligence, against the instructions of other partners, or without their assent, he should make it good. (Yajnavalkya, 2.265).

The requirements for obtaining the necessary authorisations and instructions would suggest that the partners were in frequent consultation with each other at partnership meetings.[16]

Yajnavalkya referred to partners making private profits:

> If any one of them is found to be crooked, the other partners should turn him out, depriving him of any profits that he may have earned. (Yajnavalkya, 2.265).

It is not clear whether this covered private gain from the partnership business or the profits of a competing business, or both.[17]

Partnership rules governing third parties' relations are absent from the Smriti literature, with the possible exception of a passage from Brhaspati which may be construed as touching on this aspect of law:

> If any one of the partners has been so authorised by several partners, whatever property he may give or lend, and whatever written contract he may enter into, shall be regarded as having been done by all the partners. (Brhaspati, 14.5).

Even if "several partners" is understood to imply partnership majority[18] it is not clear whether Brhaspati intended the rule to determine partners' rights and liabilities *inter se* or to encompass rights conferred on third parties against all the partners. The former appears to be more consistent with the level of legal sophistication of the Smriti rules.

Roman law, in this context, considered the authorisation of a partner to be a matter of contract between the partners involved and *only* partners granting the mandate were bound by it. Third parties, on the other hand, had no rights against the other partners, even though they might have expressly authorised the contract. Similarly, Jewish law in the first century displayed extreme aversion to the risks of agency by exempting partners from unauthorised acts of co-partners leading to a loss. In the case of such acts turning a profit, however, all the partners were entitled to share in it.[19]

In summary, it would appear that a third party in a Vedic partnership transaction could look only to the partner he contracted with, although the latter had recourse to *all* members of the partnership. In the absence of bankruptcy provisions in those times, each partner would have been liable, without limit, for his debts with the result that, even under these rudimentary rules, joint liability of partners could be achieved by a third party although in an indirect way.

Duties and Diligence

Duties of partners are referred to only in the context of partners' duties in the recovering of a partnership loan:

> That which has been lent by several persons conjointly should also be demanded by them conjointly; any such lender who fails to demand the loan together with his partners,—or otherwise to co-operate with them in the carrying on of the business—shall forfeit his share of the profit. (Brhaspati, 14.19).

There are two modes of default, both punishable by forfeiture of profit, referred to here:

1. not participating in the demand for the recovery of a jointly made loan, and
2. not co-operating with other partners in the running of the business.

It should be noted that in the first case forfeiture of the defaulter's share of the loan is not intended. In the passage, "profit" may refer to interest due on the loan or, less likely, the agreed share of profits from the borrower's undertaking financed by the loan. The word used by Brhaspati is *"labha"* which means "profit"—although one would expect the word *"vriddhi"* (literally "the increase") to mean "interest" as was the more usual usage in the Smritis and thereafter.

Participation in the partnership business appears to have been seen by Brhaspati as a *duty* as opposed to a *right* as in present law.[20] Although the degree of a partner's involvement necessary to meet the requirements of Brhaspati's rule cannot be quantified, it is nevertheless of economic significance in that it constrained an idle or obstructive partner, thereby encouraging greater partnership efficiency.[21]

Diligence over and above the normal call of duty was to be rewarded:

> If a partner has saved the merchandise from dangers (due to the king or to robbers and so forth),—he should receive the tenth part of that merchandise as his reward. (Yajnavalkya, 2.265).
>
> That partner, who by his own efforts, saves the merchandise from dangers due to the act of God or of the king, shall receive the tenth part of that merchandise; the remainder being distributed among the other partners according to their respective shares. (Brhaspati, 14.10).
>
> If a partner has saved a commodity from thieves, or from floods or from fire, he should receive its tenth part; this rule applies to all commodities. (Katyayana in *Smritichandrika).*

Although the preoccupation of the Smriti writers with a fixed 10% reward may be attributed to a lack of originality of thought, or a reluctance to deviate from a well-established practice, the rule does provide an early recognition of the need to make some special provisions for partnership emergencies, an aspect which is covered in present Indian law.[22]

Disputes and Deceit

It would appear as if disputes among partners were to be settled internally without recourse to litigations:

> Partners in a joint concern shall be their own auditors[23] and witnesses in all cases of dispute or cheating,—if there is not previous enmity between them. (Brhaspati, 14.6).

The consequences of a lawsuit taken to the king may not, however, have been as drastic for the Societas, where litigation among partners was held to be against "brotherly" spirit and any action terminated the contract, action was therefore for general winding up rather than remedy for a particular breach.[24]

There is another reference to partnership misdemeanour:

> When any one among the partners is found to have practised deceit in purchasing or selling, he should be cleared by oaths (ordeals);[25]—this same rule should be followed in all disputes. (Brhaspati, 14.7).

It is not clear whether this relates to fraud on third parties or on co-partners or both. Given that the rule mentions "partners" and is found with other partnership rules, one is led to conclude that this rule relates to partnership transgressions which are of a more serious nature than covered by the previous rule.

An Evaluation

Two major problems are recognized in establishing the legal status of the Smriti texts. Firstly, there is an unmistakable confounding of commendatory rules *(niyama)*[26] and rules which were meant to be positive and imperative in character *(vidhi)*. The second problem, one which the Smriti writers themselves commented upon, relates to the resolution of conflict between the various sources of law. Derrett[27] interprets Narada as saying "that (all) litigation rests on four feet (or moves on four feet), as it were, namely *dharma* (righteousness), *vyavahara* (practice), *caritra* (actual usage in the sense of custom) and *raja-sasana* ('royal decree'), . . ."—in case of conflict, Derrett observes that the latter sources would take precedence over the former.

Partnership rules which constitute a very minor part of the Smritis have, understandably, received only a cursory attention from scholars of the wider subjects of ancient Indian law and economics. Because of this it is difficult to determine from the literature just how common the partnership form of business association was during this period. To accounting historians, however, the subject is of more direct interest and even in these primitive rules one is able to discern concepts of partnership economics and equity which contribute to the basis of partnership law as we know it today.

FOOTNOTES

[1] Prasad, p. 169.

[2] The Smritis are not comparable with the institutes of Justinian as "they cover far more than law and do not cover the whole of the law. They are manuals of conduct, but they leave large tracts to custom. These circumstances explain their failure to create a real science of law". See Prasad, p. 159.

[3] Jolly, pp. XVI—XVIII, 276.

[4] Jha, pp. 251-264.

[5] Sacrifices to the gods were widely practised in Vedic India involving offerings of food, drink, sheep, and goats. The ceremonies had to be performed in strict accordance with the Vedas by suitably qualified priests.

[6] Kane, 1941, pp. 1188-1189.

[7] Derrett (1975), p. 158.

[8] Buhler, p. 291.

[9] Sengupta, p. 244.

[10] Buckland and McNair, p. 300. Derrett, in an oblique look at ancient partnership associations, suggests that the symbolic act of footwashing in the New

Testament established a partnership between the washers and the washed. See Derrett (1977b), p. 9.

[11] Kane (1933), p. 249. Kane's translation was preferred here, as being more literal and less ambiguous than Jha's, at the suggestion of Professor J. D. M. Derrett in personal correspondence.

[12] Kane (1933), pp. 249, 468.

[13] Note the similarities with the profit sharing rules for priests as stated by Manu.

[14] Nicholas, p. 186.

[15] Buckland and McNair, 302.

[16] Sternbach, p. 495.

[17] This distinction is made in the Partnership Act 1890 Sections 29 and 30. See, for instance, Hesketh pp. 165-166.

[18] Derrett observes that in Smriti partnerships one found a rare example of "decision by majority, which is normally anathema to Indian tradition." See Derrett (1977a), pp. 89-90.

[19] Derrett (1977b), p. 14.

[20] See Section 24 (5) Partnership Act 1890, and Section 18 (e) Uniform Partnership Act 1966. See, for instance, Hesketh p. 164 and Bromberg p. 572. Judicial interpretation has considerably extended the scope of Section 24 (5) which merely ensures through "may take part" that, unless specifically agreed, a partner cannot be excluded from participation:

> "The Act does not add (but the law implies) that each partner shall attend to and work in the business—and if he fails to do so it is a ground for dissolution and the Court may order him to make compensation to the industrious partner for the extra trouble caused by his own idleness" *Airey v. Borham* (1861). See Hesketh, p. 85.

[21] This rule would seem to preclude sleeping partners although this was permitted in an earlier period in the writings of Gautama (around 600 B.C.) for the elite Braham caste. See Spengler, p. 85. Derrett, on the other hand, holds that sleeping partner arrangements were quite common. See Derrett (1977a), p. 91.

[22] "A partner has authority, in an emergency, to do all such acts for the purpose of protecting the firm from loss as would be done by a person of ordinary prudence, in his own case, acting under similar circumstances, and such acts bind the firm." Section 21, Indian Partnership Act, 1932. See, for instance, Pollock and Mulla p. 64. There is, however, no explicit counterpart in the Partnership Act 1890 (from which the Indian Act was derived) and the Uniform Partnership Act 1966 possibly because partnership actions in emergencies were viewed as a natural extension to normal partnership duties.

[23] The word for auditors is *"parikshaka"* which literally means "examiners."

[24] Nicholas, p. 186.

[25] Ordeals were to be resorted to when the veracity of an important item of evidence was in doubt. Brhaspati mentions nine ordeals which were to be administered according to strict procedural rules:

> In the ordeal by balance, a person who, when weighed a second time, retained his original weight, was declared innocent, while he who weighed heavier was adjudged guilty. It was held that the weight of sin made the difference . . . In the ordeal by water, an individual was immersed in water and three arrows were discharged (into the water, and injury was considered to be evidence of guilt). In the ordeal by poison one had to digest poison 'given to him according to rule, without the application of spells or antidotes' (the subject being

deemed guilty if he fell ill). . . . The Hindu law-givers tend to regard the oath as a kind of ordeal on the ground that it invokes supernatural agency.

See Prasad, pp. 179-180.

[26] An example of *niyama* is Brhaspati's advice on the qualities to be sought in a partner:

> A man shall carry on business with such persons as are of noble parentage, clever, active, intelligent, conversant with coins, expert in income and expenditure, honest and brave;—and never with such as are incompetent, indolent, diseased, unlucky or destitute. (Brhaspati, 14.1-2).

[27] Derrett (1968), p. 149.

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BOOK REVIEWS

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Howard F. Stettler, Editor, *Auditing Looks Ahead—Proceedings of the 1972 Touche Ross/University of Kansas Symposium on Auditing Problems* (Lawrence, Kansas: School of Business, University of Kansas, 1972, pp. 135, $5.00).

Reviewed by
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Auditing Looks Ahead includes eight invited papers and seven discussants' responses presented at the first Touche Ross/University of Kansas auditing symposium. Since 1972, these symposia have been held biennially. As of this writing there have been five proceedings published, and with a sixth symposium presented in May 1982. The papers and discussions at the first symposium were concerned with contemporary auditing problems of 1972 vintage. The basic problems presented and discussed at the first symposium are like good wines, in that age (ten years) has not eliminated the problems but has just changed their flavor. Thus, someone involved in a current auditing problem or an historian interested in a quick overview of a problem as it existed in 1972 might benefit from reading one of the presentations or discussions given at the 1972 Touche Ross/University of Kansas Symposium. Because so much has changed in ten years, and these papers cover descriptive research of the state of the art, I have attempted to summarize, sometimes by giving little more than the title of the paper, and only minor evaluation, if any, of the paper's contribution to the profession, as might ordinarily be done in a book review.

R. G. Brown and Roger H. Salquist in "Some Historical Auditing Milestones; An Epistemology of an Inexact Art" attempt to order the evolutionary process of the history of auditing by describing audit milestones classified by era, e.g., emergence era, and then by socio-econo-technological influences, e.g., industrial revolution. Their objective of attempting to give order to the evolutionary process which has shaped the present state of the art, may have been and still may be an impossible task, especially in a short article. Horace G. Barden, as discussant, correctly pointed out that Brown and Salquist missed some important milestones and different people have different opinions as to the importance of past auditing events. The value of Brown and Salquist's attempt to pinpoint the milestones in auditing is that it is a springboard that others in the field can use in order to obtain a quick overview of auditing milestones, and a starting point for more comprehensive search for milestones and reasons.

In "What Are the Courts Saying to Auditors?" A. A. Sommer provides an excellent summary of common law developments, statutory laws, and recent important common law cases involving the auditor's liability, through 1972. Of course, like all problems of 1972 vintage, auditors continue to audit and the courts continue to render opinions concerning the auditors' duties and responsibilities. Today, updated versions of most of what Mr. Sommer discussed are found in any good auditing textbook.

Kenneth W. Stringer's paper, "Toward Standards for Statistical Sampling," summarizes the AICPA's Committee on Auditing Procedure work that led to Appendix B of SAP No. 54, which later became codified in SAS No. 1, Section 320, Appendix B, *Precision and Reliability for Statistical Sampling in Auditing,* and finally has been superseded in 1982 by SAS No. 39, "Audit Sampling." Discussant James W. Kelley questions the need to perform compliance tests of internal control procedures and implies one might perform a more efficient audit by not relying on the internal control system and using a high confidence level (e.g., 95%) in the performance of substantive tests instead of a lower confidence level, if the auditor were to rely on internal control as SAP No. 54 suggests. Kelly's point, not performing compliance testing and thereby not relying on internal control, has finally been formally recognized some ten years later (August 1982) in SAS No. 43, "Omnibus."

In "Future Extensions of Audit Services; Meeting Investors' Future Needs" Donald J. Bevis discussed the need for public companies to publish forecast data in order to meet investors' needs. Despite his enthusiasm and cry for speed, implementation of forecasts has not to date emerged. Few, if any, annual reports carry forecast data.

In "Toward Standards for Materiality (?)" William Holmes suggests a practical alternative to defining materiality, which he believes should be left to courts. Mr. Holmes' alternative to defining materiality is for the profession to establish a standard of "significant distortion." Significant distortion occurs when financial statements *per se* might cease to be "fair." Sam M. Woosley discusses Holmes' paper by suggesting a framework for defining materiality. Both Mr. Holmes, before the 1972 proceedings, and Mr. Woolsey, after the 1972 proceedings, had articles on this topic in the *Journal of Accountancy*.

"Toward a Philosophy of Auditing" by R. K. Mautz offers some thoughts on (1) to whom are auditors responsible and (2) for what are auditors responsible. Mautz concludes that neither management nor the general public is the auditor's client. An auditor should "steer a course that gives proper respect to the relative rights of the several interests in the auditor's work. . . ." Mautz concludes that the client relationship between an auditor and shareholder is strongest since shareholders have the greatest relative interest, while it is weakest between auditor and the general public. Mautz then discusses for what are auditors responsible by concluding that the auditors are responsible for not only technical competence, but also what he defines as "social competences."

In "Future Directions for Auditing Research" Douglas R. Carmichael attempts to summarize auditing research as it relates to various research methods, and to give examples of auditing research. He suggests that empirical research with data from real practice situations, excluding surveys, and not abstract data, is most needed in the profession.

He outlines three areas where research in auditing appears to be important. These are: (1) expansion of the attest function, (2) refinement of auditing methods, and (3) professional responsibilities. Frederich Newmann's response to Mr. Carmichael's paper is that the usefulness of auditing theory drawn from practice is difficult because of the difficulty of isolating a variable, and may be illusory because practice is inconsistent, unorganized, and unsystematic in its approach to problems. Newmann suggests greater cooperation and joint research ventures between academicians and practitioners.

Finally, Marvin L. Stone's dinner address, "The Problem with Auditing Is . . . (The Stuff Dreams are Made Of)," is an entertaining scenario of dreams about Marvin as an expert witness who, in one dream, explains what the SEC and an auditor do by comparing them to football officials, with the SEC having the whistle, and the players being audited public companies.

Since Symposium I is now over ten years old, it·gives historians a glimpse at what some of the leading auditing academicians and practitioners of 1972 thought were the contemporary auditing issues then and their opinions as to how these issues might be resolved.

Charles William Lamden, *The Securities and Exchange Commission: A Case Study in the Use of Accounting as an Instrument of Public Policy* (New York: Arno Press, 1978, pp. 353, $31.00).

Reviewed by
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Charles William Lamden completed *The Securities and Exchange Commission: A Case Study in the Use of Accounting as an Instrument of Public Policy* in 1949 as a part of his requirements for the degree of Doctor of Philosophy. As the title indicates Lamden intended to discuss the use of accounting in public policy. While he referred to the active and passive use of accounting he did not present a convincing argument for or against the use of accounting as an instrument of public policy. Neither did he demonstrate very well how it has been used in this way. However, Lamden did present an excellent history of the early issues confronted by the SEC and the accounting profession.

This book includes eleven chapters, most of which relate to one of three areas:

1. Early standard-setting process with and without the SEC.
2. Major issues confronting the profession during the late 1930s and the 1940s.
3. Significant areas of controversy on which the profession and the SEC sometimes disagreed.

Chapters related to the first area remind the reader that the profession has been and continues to be self-regulating and frequently takes the initiative in problem solving and standard setting. Many of the major issues discussed by Lamden continue to be major issues today and controversies between the profession and the SEC may not have been resolved.

As one progresses through *The Securities and Exchange Commission* he is alternately impressed by the tremendous progress and the lack of progress by the accounting profession. Within three pages, both conclusions can be drawn. In Chapter VII, Lamden reviewed the SEC requirements for financial statement presentation.

When discussing the requirements for the presentation of "surplus" he explained:

> If a separation can be made the amount of the paid-in surplus and revaluation surplus should be shown separately. If the separation cannot be made, it must be explained that the capital surplus is composed of paid-in, revaluation, or other types of surplus if such is the case. (p. 164)

Today this issue is solved. Not only has the profession eliminated the use of the word surplus, but it has also required that this "surplus" be properly labeled and separately reported according to source.

A short time later, Lamden discussed the concept of writing up assets to current appraised values. He explained:

> The Commission has also expressed itself as to the permissibility of increasing the surplus by appraising the assets on the balance sheet. Such appraisals are permitted if good reason can be shown for them, but the surplus arising from such revaluations must be stated separately and not included with the capital or earned surplus . . . (p. 166)

Current efforts to develop current value accounting measures sometimes confuse historical retained earnings and the effects of revaluations. The reader wonders about the pace and direction of progress when he is reminded of these 1940 issues and then he compares them to the partial solutions of today.

Lamden's book is replete with examples of this type. The modern day reader is never quite sure whether the accounting profession has progressed in its search for accounting principles or whether it has gone in circles. Sometimes it appears that the movement has been in the direction of short side trips. As one reads Lamden, he is reminded of the old adage that "the more things change, the more alike they are."

Because of this enlightening perspective of viewing accounting standard setting in light of its beginning and its current status, I highly recommend that anyone interested in the standard-setting process or progress therein read Lamden's *The Securities and Exchange Commission*.

David A. R. Forrester, *Issues in Accountability No. 4: Legislation in Process, The Belgian Accounting Revolution and its Preparation* (Glasgow: Strathclyde Convergencies, 1980, pp. 48, £ 3).

Reviewed by
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Issue No. 4 of the series, *Issues in Accountability,* discusses the process of establishing the reformed accounting legislation in Belgium. It comprises, as the subtitle indicates, "A study of background and detail with reference to Annual Accounts, Holding Companies and Accounting Plans."

In his "Introduction" the author briefly explicates the situation of Belgium and explains some of the reasons why this case is worth consideration.

The next chapter discusses the historical background illustrating *inter alia* the importance of the accounting analysts, the Belgian economic history, the Belgian enterprises, the financial situation, the organization of the economy, the stock exchanges (*bourses*) and the professional accounting situation (Belgian *Experts-Comptables* and *Revisors*). This chapter concludes with an interesting digression on the development of *Accounting Plans*.

In the following chapter, the Accounting Law of July 1975 which remains the core of the new accounting legislation in Belgium is tackled. After indicating what enterprises are subject to this Act, the author illustrates the fundamental principles underlying the Act, and the exceptions for small enterprises as mentioned in art. 5 of the Act. Turning to the different articles involved in the basic law of 1975, he briefly discusses: vouching, annual accounts, records and books, form and contents, consolidated accounts, smaller firms (exemptions of art. 12), implementation, the *Accounting Standards Commission,* derogations and exclusions and the law's enforcement.

Chapter 4 subsequently deals with the Royal Decree on Annual Accounts of October 1976 implementing the basic law of 1975. The most important articles are discussed together with the Ministers' Report to the King, before turning to some differences between this Royal Decree and the Fourth Directive of the E.E.C. The role of the *Centrale des Bilans* as a depository and dispatching center of annual accounts is then emphasized. This chapter elaborates further on some principles of accounting in which leasing, the overall fiscal influence in reflecting true and fair values in the accounts, together with revaluation and inflation accounting are considered. The author concludes with the illustration of the role the Belgian *Accounting Standards Commission* can play in interpreting accounting principles.

Although consolidation was not settled within the previous accounting legislation, a special Royal Decree was issued in November 1977 dealing with consolidation for holding companies. This topic is discussed in Chapter 5, showing the failure to consolidate group accounts with the example of the largest Belgian holding company, *Société Générale de Belgique.*

Chapter 6 reopens the discussion on the Uniform Systems of Accounts. As mentioned in the Law of 1975 and the Royal Decree of 1976, a *Minimum Normalized Chart of Accounts* had to be elaborated and was finally imposed through a new Royal Decree of March 7, 1978. Forrester emphasizes also in this chapter the importance of commitment accounting together with claims and counter-claims. He concludes this chapter discussing the C.I.G.E.C. (Centre d'Information de Gestion des Experts Comptable), pointing out that data processing exchanges between France and Belgium were facilitated "by the use of compatible Plans Comptables in each country" (p. IV/42).

Management accounting aspects are briefly summarized in Chapter 7. Forrester concludes this *Issue No. 4* with the following assertion: "In aspiration over decades, and now feasibly, Belgian accounts fulfil both capitalist and socialist purposes, and inform private and public decisions. If for this reason alone, the intent, the wording and the effects of recent Belgian accounting legislation is worth attention" (p. IV/44). *Issue No. 4* ends with a postscript on holding companies, some bibliography and annexes showing pre-reform published information, a model balance sheet and Profit & Loss account under the 1976 Act and the Chart of Accounts of 1978.

Issue No. 4 contains a tremendous amount of precious information on the Belgian case in developing accounting legislation, so that the reader who takes a quick glance at it might well be favourably impressed. We also do agree with Professor J. P. Gillet in his foreword to *Issue No. 4* that "Writing such a comprehensive and understandable article on the new Belgian accounting legislation is no small achievement and the author deserves congratulations." This performance is even more impressive if we consider that the author is a foreigner.

Nevertheless, a more profound investigation reveals a number of weaknesses, errors, and shortcomings. One of the major difficulties of the author in tackling this topic will certainly have been the language problem. When scrutinizing his bibliography, for example, no Dutch articles are quoted.

The Dutch literature, however, would have revealed another approach in the discussion on annual accounts and the increased demand for information. The French approach traditionally inclines to more emphasis on the registration regulations, as where a Dutch approach emphasizes more *disclosure* requirements. This controversy led to the adoption of the first Draft of a Fourth Directive as the basis for further discussion on implementing a new accounting legislation in Belgium. The difference in emphasis can best be illustrated when taking into account another prior aspect of the total renovation in information disclosure requirements in Belgium, i.e. the Royal Decree of November 27, 1973 providing financial and economic information to the Industrial Relations Councils. It is really a pity that Forrester excluded this Royal Decree from the scope of his analysis because in it the main emphasis was placed on *disclosure* rather than on *registration* requirements. "The requirements of the types of reliable information that should be released (disclosed) are indeed more important than are the requirements of how the accounting data must be processed. In this regard, we can refer to the etymological sense of the words, where "enregister" means to put into registers (input—*opsluiten* van informatie) and "disclosure" has just the opposite meaning, that is to release information (output—*ontsluiten* van informatie)."[1] In the same context, it must be observed that a great many terminology problems emerged in the translation of the French texts into the Dutch version, due to the fact that preliminary drafts were in most cases originally drawn up in French and translated into Dutch afterwards. So, for example, the French text is dealing with "*avoirs*" which implies all "assets" of the firm, while the Dutch counterpart incorrectly translates "*avoirs*" as "*tegoeden*" which means "*receivables.*"[2] Forrester, however, only notes that "Laws and decrees are of course drafted and enacted both in French and Flemish," (p. IV/17) not considering the terminological problems in the sense mentioned above (p. IV/19-20). Belgium has a problem like that of the E.E.C. in general. Namely an accounting standard in one language must be almost totally rewritten for another language. In all E.E.C. legislation, the translation from the original working text to the member languages is not a trivial problem, but must be carefully executed by experts in accounting.

As to the discussion on the role of the Public Auditors in Belgium, Forrester did not mention an important Recommendation to the Government by the National Economic Council of July 12, 1972.

As to the auditing profession in Belgium, three major problem areas might be discerned:

a) accounting standard setting does not exactly imply that auditors will meet the standards, leading to a performance gap. Furthermore an expectations gap will occur due to the fact that public expectations of the work performed by the auditors might differ from the standards set by the profession.
b) the profession is confronted with a vicious circle of low fees, low scope, low quality, low image and low fees.
c) the problems arising from an audit monopoly situation in Belgium, where only a very restricted number of public auditors can legally and officially perform the audit required for firms quoted on the Stock Exchange.

After several drafts, a Royal Decree dealing with Public Auditors might at last appear in 1983.

The introduction of a Minimum Normalized Chart of Accounts in Belgium (p. IV/37-42) was also a strongly debated topic, although the organizations of accountants and revisors (public auditors) favoured such a Royal Decree on Uniform Systems of Accounts. The discussion centered around advantages and disadvantages of Uniform Charts of Accounts. The merits of Uniform Systems of Accounts, however, should be measured by criteria, such as:

a) information criteria: defining *what kind of information* the accounting system should be able to provide.
b) control criteria: the accounting system should be able to provide *reliable information.*
c) economic criteria: reliable information should be processed in *economically acceptable conditions*, in a *labor-saving* way.

Turning to the discussion on E.D.P. processing, Forrester refers to "such modern data processing methods" (p. IV/29. In reality there exists a very large gap between the accounting practices and the text of the new accounting legislation. Art. 8 of the Law of 1975 emphasizes mainly the importance of books, which must be "certified, numbered and initialled" (p. IV/20), leaving some possibilities open to "replace them by alternative measures guaranteeing the regularity, completeness and continuity of matter in the books" (p. IV/21). Nothing much, however, has been realized in this matter up till now. In this way, art. 8 is introducing a modern anachronism into a body of new accounting legislation.

As to the company financial data deposited and dispatched on computer tapes through the special Agency of the Central Bank of

Belgium (*Balansen centrale—Centrale des Bilans*), recent studies of Jegers and Buijink have demonstrated that registered annual accounts do not meet the necessary criteria of reliability. So for 1980, for example, they conclude that less than seven percent of the annual accounts are reported correctly.[3] Omissions and arithmatic errors are numerous and are not merely due to transcription inaccuracy.

About the *Tableaux de financement* or Funds Flow Statements (p. IV/25) Forrester argues that the "government anticipated that the law would eventually require" (p. IV/25) such statements. If he had been working through some preliminary working texts or drafts, he might have discovered that Funds Flow Statements were required, but that in later drafts this topic was finally dropped and given as a general consideration in the Report to the King. In light of this opposition, it might still take many years before Funds Flow Statements, however defined, might be accepted in new accounting legislation.

Also the Belgian legislators have been inconsistent in dealing with inflation accounting. No alternative methods are imposed on Belgian companies to show the effects of inflation on annual accounts, except for replacement costing and revaluations. This differs from the Fourth Directive. It is too strong an assertion to say that "replacement cost accounting . . . is forbidden except as auxiliary calculation and report in the decree" (p. IV/28), because firms are allowed to use this method.

If many firms do not use replacement cost accounting it is merely due to the fact that this system is not acceptable for the Belgian Tax Authorities. Furthermore, Forrester is wrong in arguing that "base stock methods for inventory valuation" (p. IV/31) are allowed in Belgium.

The author of *Issue No. 4* stresses the deficiencies in the Profit and Loss account (p. IV/25) only based on the nature of costs. He omits in his analysis to mention the difference between the Royal Decree of 1976 and the Fourth Directive on this matter (p. IV/27-28). The Fourth Directive allows also for a Profit and Loss account presented on the basis of cost allocation. The Belgian Royal Decree does not, suggesting that the Belgian legislators still have to discover modern analytical cost accounting methods. This might also help to explain why in the Minimum Normalized Chart of Accounts classes 8 and 9 are left free and undefined, and could of course be used especially for Cost Accounts. (Appendix IV, see also p. IV/40)

It is furthermore somewhat surprising to see that Forrester wants to present a current picture of the Belgian economic environment *anno* 1980 (publication date) when on several occasions he refers to statistical data which were already ten or more years old. For example, data on "Companies registered at local Commercial Courts" goes back to 1970 (p. IV/8), Cobbaut's study on dividend policies of 1969 covers the period 1946-1965 (p. IV/10) etc. . . . At least the author should have updated his empirical evidence in the text.

Finally, I believe *Issue No. 4* deserved a better editing. Photoprinting from a typewritten copy sometimes results in an illegible presentation. This is especially true in the Appendixes.

Although *Issue No. 4* contains several faults and shortcomings it remains a valuable piece of research and provides the nonspecialist and non-Belgian a concise and comprehensive overview of the topic. In this regard, it would be appropriate for classroom discussion.

FOOTNOTES

[1] Lefebvre, p. 114.
[2] Lefebvre, p. 115.
[3] Jegers and Buijink.

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Arundel Cotter, *Fool's Profits* (New York: Barron's, 1940. Reprint edition, New York: Arno Press, 1980, pp. ix, 174, $16.00).

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Fool's Profits is a series of articles that were originally published in *Barron's* during the period, August through November, 1939, plus three appendixes containing sections of government documents relating to the acceptability of LIFO for income tax purposes. Cotter indicated, "this volume is not written primarily for the accountant, but rather to the corporate executive, particularly those concerned with finances, and directors as well as students of corporate finance and business generally" (vii). The book represents a crusade by Cotter to get corporations to adopt LIFO rather than FIFO.

Cotter's advocacy of LIFO arises primarily from the belief that it will result in smoothing income. He has no real concern for balance sheet valuation of inventory. His approach to this advocacy is to provide examples of the effects on profits of industries and companies within industries over periods of five to twenty years. In addition, he provides, as examples of how smoothing is obtained, some simple numerical computations. Peculiarly, he is so enthused about LIFO that he continually refers to it as "inventory control."

The book might have had considerable impact at the time of its publication and it might have been an important book at that time; however, it is not a book that I would recommend be high on one's reading list. I found the costs of reading the book far exceeded any insight into accounting thought at that particular time and accounting thought during the second quarter of the twentieth century is a subject in which I am interested. Perhaps, one of the reasons for my negative attitude towards this book is that I recently read Devine's book on accounting for inventories [1942]. The Devine book which was published about the same time as *Fool's Profits* was written for accountants and, even though it is somewhat boring at times, it provides a great deal of insight into the origins of LIFO and accounting thought of the period.

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DOCTORAL RESEARCH

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All of the studies reviewed in this edition have to do, in one way or another, with impact assessments: the majority of them involving accounting regulation. We commence with the broad regulation of accounting practices by the federal government through specific legislation. Chow's study of the impact of accounting regulation on investor wealth, although pointed towards the need for assessing the economic effects of accounting regulation, uses the 1933 and 1934 Securities Acts in testing his hypotheses. Johnson shifts the focus to management stewardship as he gathers data on specific accounting changes which firms introduced in response to the requirements of the Foreign Corrupt Practices Act of 1977.

The Treasury Department also plays a significant role in shaping accounting practice. Professional accountants and tax authorities have been battling over code language and application interpretations for decades, yet ambiguities and incongruencies persist. Lett provides strategic advice to both the Internal Revenue Service and taxpayers, based on his study of court decisions which distinguish tax-deductible business losses from nondeductible, unprofitable hobbies. Aharoni raises behavioral issues in his examination of the ways in which corporate taxation affects management's choices between accounting alternatives. Beirne is concerned about other aspects of corporate tax policy: notably its neutrality and provisions for equality of treatment. These policy attributes are questioned in his review of the taxation of the undistributed income of controlled foreign corporations.

Turning to the profession's own internal regulatory activities, the remaining four dissertations ask basic questions about required practices and obtain mixed results. Haselkorn evaluates pension expense accounting, as required by Opinion No. 8 of the Accounting Principles Board (APB) and concludes that it does not accomplish the Board's stated objectives. Gean questions the APB's position on the interperiod allocation of depreciation timing differences, as expressed in Opinion No. 11, and finds general support for the Board among groups influential in the development of accounting standards. Barber, on the other hand, asks whether the format of the funds statement matches its intended purposes, finds that it does not, and develops a superior model. The final dissertation, by Clark, moves in to look at one area of the profession's self-regulation, nonaudit accounting services. His review of the evolution of standards for unaudited financial statements, describing the 40 years which elapsed before the nonaudit function was segregated in 1979, provides one more testament to the slow deliberation with which the profession charts its progress.

An Investigation of the Wealth Impacts of the 1933 and 1934 Securities Acts' Financial Disclosure Requirements (University of Oregon, 1981; 42/05, p. 2184-A[1]) by Chee Woo Chow. The burgeoning of mandated accounting standards in recent years has brought about an awareness of the need to consider their economic consequences. Thus, Chow was motivated to examine the nature and incidence of impacts on investors' wealth which could be attributed to accounting regulations. Prior research has confined itself to searching for evidence of impacts on stock returns, without specifically investigating the root causes of these effects. Chow, however, looks into the reasons why these impacts occur and he broadens perspective by including bond returns in his inquiry.

The study's theoretical justification rests on agency theory. Briefly put, this theory posits that contracts made between managements, stockholders, and bondholders, moderate conflicts of interest and rely on accounting-determined numbers. If unanticipated changes are subsequently required in the groundrules for calculating these numbers, there could be effects on the nature of these contracts as well as financial implications. Any resulting changes in the wealth of the contracting parties would depend on the degree to which their interests conflict as well as the distinctive features of the contractual arrangement.

Chow tested these theoretical hypotheses on the Securities Acts of 1933 and 1934, using a control group of over-the-counter stocks and a treatment group of stocks and bonds listed on the New York Stock Exchange. Across three time intervals, a control period, a favorable event period, and an unfavorable event period, he compared daily security returns, using non-parametric tests. He found that shareholder wealth was decreased, and bondholder wealth in-

[1] *Dissertation Abstracts International*, volume and page references.

creased, by the 1933 Act. His predictions that contributing factors would include leverage, the number of accounting-based debt covenants, the tightness of these covenants, and firm size were moderately supported by regression tests. Chow also found that the 1934 Act's sales disclosure requirement was the only factor affecting shareholder wealth. He attributes this to the fact that the 1934 Act's other accounting provisions may well have been predictable a year earlier.

The Foreign Corrupt Practices Act of 1977: An Inquiry into the "Accounting Provisions" of the Act Including a Study of Explicit Responses by Corporations (Louisiana Tech University, 1981; 42/05, p. 2185-A) by Kenneth Lester Johnson. In 1977, the Congress passed the Foreign Corrupt Practices Act (FCPA) containing certain accounting provisions which were intended to preclude the possibility of overseas bribery being concealed by improper accounting practices. Little is known, however, about explicit responses which the FCPA may have evoked from companies potentially affected by the legislation. The main purpose of Johnson's dissertation was to learn what the "Fortune 500" corporations have done in this area. First he reviewed the accounting literature for suggestions as to how corporations should respond to the FCPA's accounting provisions. He then synthesized them into twenty-seven recommended actions and incorporated them into a questionnaire. This was then mailed to the chief financial officer of 166 industrial corporations included in the "Fortune 500," resulting in the return of 102 usable responses. The questions asked were classified into six topics: internal accounting control, corporate code of conduct, independence and involvement of the corporate board of directors, enforcement of corporate policy, the role of auditors, and FCPA-related management information systems. The respondents were asked which of the twenty-seven recommended actions had been implemented before passage of the FCPA, which after, and which had not been implemented. The responses indicated that many of the actions listed in the questionnaire had been implemented and mainly before enactment of the FCPA. The motivation to initiate recommended actions is apparently inversely related to cost and degree of complexity, but directly related to the visibility of the action. Actions taken as a result of the FCPA included: "(1) Over 62 percent of respondents initiated a comprehensive review of internal accounting controls; (2) over 50 percent of respondents adopted, revised, expanded, or strengthened their codes of conduct; (3) about 6 percent of respondents took actions to increase the independence or involvement of the board of directors; (4) individual recommendations regarding corporate policy enforcement were adopted, on the average, by about 20 percent of respondents; (5) except for the fact that about 47 percent of respondents increased management's attention to internal control reports, relatively few actions were taken that affected the role of auditors; (6) over 75 percent of respondents developed a formal system to keep management informed of developments related to the FCPA."

An Empirical Investigation of Trade or Business Attributes of Quasi-Business Ventures Under the Internal Revenue Code (University of South Carolina, 1981; 42/05, p. 2185-A) by Samuel Lafayette Lett. A question frequently raised by the Internal Revenue Service is whether a taxpayer's secondary venture is a business run for profit or a hobby. If the former, operating losses are deductible from income. Operating losses are not deductible, however, in the case of secondary ventures which are hobbies. The purpose of this dissertation was to identify distinguishing criteria which could be used for income tax purposes. The data base mainly consisted of Tax Court decisions and Lett used discriminant analysis to determine whether common factors appeared in the decisions which differentiated between businesses and hobbies.

As his sample, Lett selected 136 Tax Court cases decided during the period 1944 through 1979. He then specified 19 qualitative and three quantitative independent variables from data contained in the court decisions as well as drawn from Section 183 of the Internal Revenue Code. Quadratic models were developed and the criterion adopted for selecting the "best" model was selection by the Lachenbruch (jackknife) holdout method of the highest classification accuracy among the models tested. Using this method, a linear discriminant model was selected, with five variables and a classification accuracy of 94.1 percent. The null hypothesis, which was rejected at the five percent level of significance, was: "discrimination between business and hobby activities for federal income tax purposes, based on the appearance of factors in the written opinion of Tax Court judges, is no more effective than random estimates based upon chance." The best model identified the following key distinguishing factors: records, operational plans, changes in activity to improve profitability, the taxpayer's expertise, and the amount of time spent on the activity by the taxpayer. To control for measurement errors which might introduce bias, three independent audits were porformed. This need was supported by the fact that two of the audits brought out numerous errors. No systematic bias was evident, however, from the models based on audit data.

The Impact of Taxation on Accounting (New York University, 1980; 42/01, pp. 283-4/A) by Amram Aharoni. This dissertation investigates the dual problem of how taxation affects both economic and information decision-making by corporate managers. The underlying theory posits that behavioral adaptations can be anticipated when changes in fiscal policy increase the transfer of resources from the private to the public sector. This could be particularly true in the case of corporate managers who are both individual consumers as well as executives financially motivated through corporate performance. One could expect that they would tend to make compensating accounting changes in order to achieve an optimal equilibrium of personal wealth, given new tax constraints.

The study commences with a review of major events in the history of corporate taxation and relates them to the development of some important accounting principles. It then goes on to assess how taxation affects economic decisions by corporate managers and the manifested effects on accounting, particularly on profits. The author next addresses the second part of his problem: taxation's impact on information decision-making, by developing a model which shows how fiscal policy changes affect management choice among alternative accounting techniques. This model generated hypotheses which were later subjected to an empirical cross-sectional test, and the results generally supported the theory. Briefly stated: a manager's choice was dichotomized to nonconformity or conformity. Under nonconformity, an increase in the effective corporate income tax rate triggers an increase in reported accounting earnings. Under conformity, the relationship between the tax rate and reported income will depend on the structure of management compensation plans. If, for example, a manager receives a relatively large stock option, a tax rate increase is associated with a reported earnings increase. If the option is relatively small, however, a tax rate increase would indicate that reported earnings would be increased if the bonus were small and decreased if the bonus were large.

Another strategy used by corporate managers is to lobby for changes in generally accepted accounting principles. Aharoni demonstrates that lobbying activities have an optimum level above which there is sensitivity to change in the corporate income tax rate. There is a positive relationship between the optimum level and the rate when a proposed accounting change deals with a nonconformity item. However, the sign of the correlation when a conformity issue is involved will depend on a firm's management compensation plans as well as its effective tax bracket.

An Investigation into the Taxation of Undistributed Income Sections 951 Through 964 of the Internal Revenue Code: The Controlled Corporation (The University of Oklahoma, 1981; 42/02, pp. 769-70/A) by Thomas Joseph Beirne. This study should be of considerable interest to income tax historians, particularly in the area of international business. Beirne's research problem concerned the relationship between the taxation of undistributed income and enactment of statutes which identified foreign corporations controlled by U. S. owners. Starting with the introduction of income taxation in 1913, Beirne traced the development of various laws which affected the taxation of both undistributed income and the income of U. S. controlled foreign corporations. He then analyzed certain events which occurred, and studies which were made, during the period 1953-1962 and compared the legislation which had been expected with that subsequently enacted. The following two decades or so were marked by legal contests. Beirne reviewed the most significant court cases during the period 1962-1980, noted the changes which occurred in sections 951 through 964 of the Internal Revenue Code, and attempted to relate these changes to the outcomes of certain cases. He then went on to analyze the effects on the overall tax rates of corporations with incomes from foreign subsidiaries, covering the period 1913-1980. This analysis included an assessment of the possible effect on corporate dividend policy of having a controlling interest in subsidiaries located in countries where tax rates were higher, or lower, than in the United States.

Beirne reached three main conclusions from his study. First, that the only attempts to tax undistributed income which have lasted in the long run are those intended to reduce the possibility of tax avoidance. Policies aimed at increasing federal revenues, or attempts to eliminate deferral privileges, have been neither popular nor successful. Secondly, that numerous court cases to test Code sections 951 through 964, during the period 1962 through 1980, mainly resulted in decisions in favor of the Internal Revenue Service. The taxpayers only prevailed in cases where tax avoidance was not a contributing factor. Thirdly, that the intent of the Kennedy Administration's tax policy was to try to be neutral in terms of possible effects on management decision-making, and achieve equality of treatment by taxing similar types of income at similar rates. Neutrality with respect to corporate dividend policy does exist where foreign subsidiaries are operating in countries with tax rates equal to or higher than those in the United States. However, tax equality is obviated by the deferral privilege. In order to achieve both equality and neutrality in tax policy, Beirne suggests, the deferral privilege must be eliminated or else extended to corporations which operate overseas through branches rather than subsidiaries.

APB Opinion No. 8 and Fluctuation in Pension Expense: A Case Study in the Effectiveness of Accounting Regulation (The University of Chicago, 1981; 42/03, p. 1220-A) by Michael Haselkorn. As its title indicates, this dissertation evaluates the effectiveness of employer accounting for pensions, as required by Opinion No. 8 of the Accounting Principles Board (APB). Although APB Opinion No. 8 was intended to accomplish several objectives, the one tested in this study was that which aimed at eliminating fluctuations in reported pension expense which were not related to the employee group. Two sets of hypotheses were tested, the first being:

> "H_O: The number of firms which have exhibited an increase in fluctuation of reported pension expense relative to payroll, after APB Opinion No. 8, is greater than or equal to the number of firms which have exhibited a decrease in fluctuation of reported pension expense, relative to payroll, after APB Opinion No. 8.
>
> H_1: The number of firms which have exhibited an increase in fluctuation of reported pension expense, relative to payroll, after APB Opinion No. 8, is less than the number of firms which have exhibited a decrease in fluctuation of reported pension expense, relative to payroll, after APB Opinion No. 8."

The second set of hypotheses was developed for that aspect of the study which dealt with the use of pension expense as an agent for income smoothing:

> "H_O: For those firms having reduced fluctuation in reported pension expense relative to payroll, reported net in-

> come fluctuated the same before and after APB Opinion No. 8.
>
> H_I: For those firms having reduced fluctuation in reported pension expense relative to payroll, reported net income fluctuated more after APB Opinion No. 8 than before it."

Haselkorn developed three measures of fluctuations applicable to pension expense: the square root of the average squared deviation from linear extrapolation of the series; the square root of the average squared deviation from parabolic extrapolation of the series, and the coefficient of variation. A fourth measure: the mean absolute error where the percentage change in pension expense was the dependent variable and the percentage change in payroll was the independent variable, used payroll as a measure of the employee group. The data base used were CRSP tapes for the period 1959 through 1974 and the firms included in the sample were those, numbering 86, which met the selection criteria and disclosed annual pension expense and payroll data for each year.

The time interval was divided into two periods: the first, 1959-1966, before APB Opinion No. 8 came into effect; and the second, 1967-1974. Using a paired sample design, the results in the second time period were subtracted from those in the first time period for each company. The Wilcoxon signed ranks test was used to evaluate the differences. It was found that there were more increases than decreases in fluctuations under all four of the measures employed. Consequently, the first null hypothesis could not be rejected. As to the possible income-smoothing aspect of pension expense, eighteen firms were found to have decreased fluctuation in reported pension expense relative to payroll. In testing the second set of hypotheses, the null could be rejected at a significant level under each of the four measures. Haselkorn warns, however, that the *ceteris paribus* assumption could be questioned and that these results, therefore, should be treated cautiously. The author's major conclusion was that one of the main objectives of APB Opinion No. 8 was not achieved. He put forward two possible contributing factors: a lack of full comprehension and consistent application of the Opinion, and that the Opinion did not affect actuarial assumptions, particularly the interest assumption.

A Study of the Desirability of Deferred Tax Accounting for Depreciation Timing Differences (Georgia State University, 1981; 42/05, p.

2184-A) by Gilbert Farrell Gean. In 1967, the Accounting Principles Board (APB) issued Opinion No. 11 which mandated comprehensive interperiod tax allocation. This requires that the tax effects of timing differences between the net income per income statement, and that calculated in the corporate tax return, including those attributable to depreciation policies, must be assigned to the appropriate accounting periods. The APB's decision not to exclude depreciation timing differences has evoked criticism on the grounds that it contributes to the disproportionate increase in deferred tax credit accounts, as compared with other growth trends reflected in financial statements. Prior research has shown that in many balance sheets examined, the deferred tax credit rarely decreases. Consequently, the argument raised by the APB's critics has some intuitive support.

Gean's research question was concerned with whether or not there are differences in attitudes towards the treatment of depreciation timing differences among those groups influential in the development of accounting standards, namely: accounting academicians, partners from the "Big Eight" public accounting firms, controllers of the "Fortune 500" companies, and senior investment officers. Accordingly, he formulated the following hypotheses:

> 1. There are no significant differences among the mean scores of influence groups as to attitude toward allocating the tax effects of depreciation timing differences. 2. There are no significant differences among the mean scores of influence groups as to attitude toward alternatives to allocating tax effects of depreciation timing differences. 3. There are no significant differences among the mean scores of influence groups as to belief about the conceptual nature of income taxes. 4. There are no significant differences among the mean scores of influence groups as to attitude toward interperiod allocation of tax effects of timing differences. 5. There are no significant differences among the mean scores of influence groups as to the attitude toward the deferred method of applying the interperiod tax allocation principle.

To test these hypotheses, Gean developed a questionnaire, containing twenty-five items of requested information, which was based on theoretical and empirical propositions gleaned from the accounting literature. This questionnaire was then mailed to a randomly selected sample of 610 members of the designated influence groups. Based on the responses, Gean developed a personal profile of the respondents, computed from the descriptive statistics supplied. Their general attitudes and beliefs were drawn from frequency distributions, means, and modal responses to the twenty-five questions. Each of the null hypotheses was tested by analysis of variance. Least significant difference posterior analysis was performed for each null rejected, in order to identify a .05 alpha level of significance for differences between mean responses of pairs of groups. The Bartlett-Box F technique was used to measure and compare differences in variability of responses within each influence group. Gean's overall conclusions were that his respondents generally supported the APB's position. However, there was variability in the attitudes and beliefs of the different groups, particularly among the practitioners, about this topic.

The Funds Statement Redesigned to Fulfill the Objectives of Financial Reporting by Business Enterprises (The University of Texas at Austin, 1981; 42/03, pp. 1233-4/A) by James Philip Barber. This study had two major goals: to determine what requirements with respect to the statement of source and application of funds (the funds statement) were contained in *Statement of Financial Accounting Concepts No. 1,* and to design statements to meet such requirements. The basic objectives of the funds statement were included in the Trueblood Committee report as well as the Financial Accounting Standards Board (FASB) Discussion Memorandum (DM) on funds flows. The main goal was perceived to be the presentation of information which would be helpful for statement users to assess the prospects for future cash flows to investors and creditors through the reporting entity. Additional objectives were seen as reporting on management stewardship of resources, and reporting on changes in and claims to these resources. These main and additional objectives formed the basis for the two models which Barber constructed: a statement of cash flow and a statement of financial activities.

The statement of cash flow explains the net change in cash during the period both from earnings as well as from investing and financing activities. The net change from earnings was developed by converting income statement items to cash flow, keeping to the income statement format. The statement of financial activities explains the excess over internally-generated funds of financing required during the period by contrasting the net changes in non-operating resources with operating activities. Barber then designed a controlled model which contained three elements: the two model statements just described; traditional financial statements; and funds statement revisions previously proposed by certain other researchers who had also followed the thinking expressed by the Trueblood Committee or the FASB. An assessment was then made of the relative usefulness of each of the three elements through an item-by-item comparative analysis. The specific accounting topics included in this analysis were: inflation accounting, installment sales, interest capitalization, change in accounting principle, and accounting for pensions. Barber's conclusion was that the two model statements he had designed were superior to those previously put forward, in terms of usefulness and being more easy for users to understand.

Evolution of Unaudited Financial Statements' Standards (University of Missouri-Columbia, 1980; 42/02, p. 752-A) by Wilbur Rhea Clark. Accounting services include the preparation of financial statements without performing an audit. Because, however, the layman mentally associates the public accounting profession with auditing, there may be a user propensity to place more reliance on unaudited statements than is intended. As a result, professional accountants have been expressing a need for separate nonaudit standards ever since the AICPA's Committee on Auditing Procedure issued the first *Statement on Auditing Procedure* (SAP) in October 1939. The profession's first attempt to segregate the nonaudit function did not come about until the publication of *Statement on Standards for Accounting and Review Services* (SSARS) *No. 1* by the AICPA's Accounting and Review Services Committee, which took effect after June 30, 1979.

Clark's dissertation had three main goals, namely, to determine the extent to which: SSARS No. 1 satisfied certain concerns expressed over its exposure draft; subjects concurred with changes made before the final statement was issued; and subjects' concerns were not addressed in either the exposure draft or the final version of SSARS No. 1. Data was gathered into two stages. First a questionnaire was sent to a random sample of practitioners, asking for their opinions on the SSARS exposure draft. The responses provided part of the input for the second questionnaire, which also contained information about changes which were made in the final version of SSARS No. 1. The responses to the first questionnaire contained the following major concerns. Concerning the compilation section of the draft: (1) reference to generally accepted auditing standards (GAAS); (2) negative assurance, and (3) inadequecy of corroborative inquiry and analytical procedures. The final version made no changes in the draft's review section and consequently the initial concerns raised about it persisted. As for the revised compilation section, respondents to the second questionnaire, in general, considered the compilation procedures to be an improvement and were pleased that the reference to generally accepted accounting principles had been eliminated. In conclusion, Clark suggested the following areas for additional research: cost/benefit analysis of compilation, review, and audit; distinguishing review services from audit services; and the impact of accounting firm size on questionnaire responses.

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