

# Accounting and auditing from Ancient Mesopotamia to Modern China--a "Reduced" history

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**British Accounting and Finance Association  
South West Regional Conference 2012  
Aberystwyth University  
Thursday 6th – Friday 7th September**

With acknowledgments to: <http://www.reducedshakespeare.com/productions/the-complete-works-of-william-shakespeare-abridged/>

# Theorising ‘accounting’ (Ezzamel & Hoskin CPA 2002)

- First, [it] is a *practice* of entering in a visible format a record (an account) of items and activities.
- Secondly, [it] involves a particular kind of *signs* which both *name* and *count* the items and activities recorded.
- Thirdly, [it] is always a form of *valuing*:
  - (i) *extrinsically* as a means of capturing and re-presenting values derived from outside for external purposes, defined as valuable by some other agent;
  - and (ii) *intrinsically*, in so far as this practice... in itself constructs the possibility of *precise valuing*.
- ‘Money of account’ (*numeraire*) (e.g. equivalent quantities of grain, copper, silver, gold in Egypt) predates physically exchangeable money.

# Theorising accounting's history

- Two main dimensions of change (*McV EAR 2002*):
- *Technological*: a) **what** kinds of 'thing' are 'named and counted' (e.g. C13th AD full monetisation in DEB; C18th (depreciable) industrial capital assets; C19th statistical populations & probable outcomes; C20th intangibles; income 'standards'; environmental and social externalities; C 21<sup>st</sup> ????.) and b) **how** (writing, Arabic numerals, paper, printing, IT)
- *Interpersonal*: new 'accountability' relationships: accounting **by** and **to** whom? (both public and private / individual and collective)

# Some historical features:

- Audit is accounting's twin: although audit by whom varies with 'agency' relationship
- Role in taxation and redistribution
- 'Professionalisation' from 19<sup>th</sup> century AD: but also cadres of ancient Egyptian 'scribes' and Chinese Imperial civil servants in public sector; cf. Greek and Roman slaves
- Information intermediaries (analysts, press etc.) with growth of 'passive' stock market investment

# Ancient accounting – and audit pre D-E

- Public / state: its written naming and counting is part of the visible ‘ordering’ of political, social and economic life across space and time, and also across the physical and the spiritual words
- Enables both public accountability (e.g. to the gods and for city/State admin) and private contracts and work organization
- Transaction records (‘bookkeeping’) are the origin of writing and support impersonal exchange and economic activity (Basu et. al AOS 2009)
- e.g. Mesopotamian bakeries; Ancient Egypt (now Ezzamel, 2012); Ancient China (Guo et al. 2011) ; Classical Greece and Rome and Roman Egypt (including ‘accruals’) (McV, *EAR*, 2002); cf ‘Dark Ages’....

# Modern FAT: rationality?

- Two recent books stress the rationality of financial accounting (largely) as it is (vs. FASB/IASB CF redesign) (Penman, 2011: 'fundamentalist'; Waymire & Basu, 2008: 'evolutionary').
- Both mainly US/UK focussed...
- NB Emphasis on 'conservative' earnings and 'hard balance sheet' (Chicago/MIT/Rochester school): now being extended from 'contracting' to 'valuation anchor to challenge stock-market price' (and even to explain 'B/P' risk anomaly in Fama-French model? (Ryan *ABR* 2012; Cohen et al. *JFE* 2009) )

# FAT: rationality and myth.....

W&B believe that DEB is a crucial tool for capitalism, albeit recognising that we cannot ***wholly*** explain FAT (either as it is or should be) as rationally designed (cf FASB/IASB CF) but rather as the outcome of a constellation of historical and institutional factors (Burchell *et al.* AOS 1980)—but, W&B believe, with a ‘survival of the fittest’ (cf. Fleischman’s review, *TAR*, 2009)

# The myths: # ONE

*Historical cost accounting (=‘recoverable cost accounting’: Solomons TAR 1961) is objective*

- Penman 2011? ‘Engineering good accounting’
- Conditions for emergence of ‘objective’ FV (Power ABR 2011)
- BUT e.g. Self-constructed assets; FIFO/LIFO
- Uncertainty and estimates e.g. Provisions for long term liabilities
- Loss of NPV  $> 0$  = no impairment. Cf ‘asymmetric timeliness’....
- M&A allocated ‘fair values’ to determine goodwill
- Are intangibles more uncertain: (cf. W&B 2008 re General Electric write off in 1907 to ‘counter signal’.....but wrote off PME too!)
- Managerial choice under PAT (Watts & Zimmerman TAR 1990) does not explain the available range of acceptable choices.
- NB: need both B/S and I/S approaches (Ryan ABR 2012)



# The myths: # TWO

*Control and audit are effective monitors in reducing agency problems*

- Cf. Ancient Mesopotamian bakeries in 3<sup>rd</sup> millennium BC (RMv EAR 2002)
  - Medieval manorial audits (Noke ABR 1981; 1994; Jones AAAJ 2008)
  - What is 'auditable' is socially constructed (Power AOS 1997)
- 

So: Audited accounts sustain corporate and public sector activity / financing through (illusion of ?) 'control / action at a distance'

# FAT as ‘institutional rationalised myth’?

- ‘Powerful institutional rules which function as highly rationalised myths’ (Meyer & Rowan, 1977; 1991)
- Become ‘taken for granted’
- But how much is rational?
- And how much is myth?
- I will briefly explore some interrelationships between modern FAT and accounting history

# Remaining Outline

## Outline:

- 1. FAT: 2 modern examples and their history
- 2. 'Economic rationalist' history
- 3. An alternative history
- 4. Implications for future FAT?
- 5. Some conclusions and implications for research
- 6. Questions?

# It's time for some accounting...(!)

- 2 modern FAT Examples:

*1. ESOs*

*2. Liabilities and discount rate  
changes*

# 1. ESOs

- shows expense/cost but not intangible asset (if incentive works) (Landsman *et al.* RAST 2006)
- NB no overall change in net assets so does not fit ‘balance sheet approach.
- appears to be driven by ‘proper matching’, e.g. Warren Buffett: Mcv 1998; Bromwich *et al.* Abacus 2010)
- ‘second best’ solution?
- Voluntary adoption as ‘counter-signal’ after Enron etc. facilitated previously fiercely resisted standard? (Zeff 1997; cf W&B 2008)

## 2. Liabilities and discount rate changes

- IAS37 now ‘off the agenda’ (Morley, 2011)
- consider ‘credit risk’ paradox under FV
- counter-intuitive ‘gain’ as rating worsens (due to omitting fall in assets/unrecorded goodwill)—‘second best’ again (cf. Barth *et al.*, *TAR*, 2008)
- Now acknowledged in October 2010 addition to IFRS9: element of FV change due to credit risk to go to OCI not P&L
- No clear conceptual solution (McV Abacus 2010)

# Liabilities (cont.)

- FV symptomatic of ‘balance-sheet’ not ‘income’ focus (e.g. Horton & Mcv, *AAR*, 2000): does not work for financial instruments if non-traded (cf. Penman, 2011)
- current inconsistencies in liability accounting result from **history** of gradually coping with longer-term and more complex financing instruments, plus new highly uncertain liabilities such as pensions, environmental etc. (Barker & McGeachin, 2011)

# ‘Economic rationalist’ history?

- e.g. Johnson & Kaplan (1987) on early US management accounting (later ‘perverted’ by regulated financial accounting rules for inventory costing, depreciation etc.) **BUT** cf. Ezz, H&McV, *ABR* 1990
- Fleischman & Parker (e.g. 1992) and Boyns & Edwards (e.g. 2007) on UK BIR cost accounting. **BUT** cf. H&McV *AHJ* 2000; Bryer (e.g. *AOS* 2006)
- Watts (2003) on emergence of ‘conservatism’ (followed by W&B 2008 and Penman 2011) **BUT** question is not ‘FV vs conservatism’ but ‘how much conservatism for different purposes?’ (Lambert *JAE* 2010)



# ‘Economic rationalist’ history? (cont.)

- ‘Evolution’ of this and other ‘fundamental accounting principles’ (Waymire and Basu 2008) **But**
- what is social evolutionary process for accounting principles? (cf. Darwinian biological **adaptation** / random mutation / genes)
- W&B agree difficult to explain **individual** a/c policy choices for good management given low ‘signal to noise ratio’. Effect of ‘institutional isomorphism’? (DiMaggio & Powell, *ASR* 1983)

# ‘Economic rationalist’ history? ***But***

- e.g. Coase (1938) and Wells (1978) re historical costs and overheads **vs.** rational management decision making.
- Hicks (1979) re 19<sup>th</sup>-century mill-owner’s income: accounts irrelevant (Bromwich et al *Abacus* 2010)
- Yamey (1977) re variety of financial accounting principles for income and valuation before 19-20<sup>th</sup> century profession and regulation (and later, standards)
- Hoskin & Mcv (2000) (following Chandler 1977) re ‘excessive’ accounting/administration in new 19<sup>th</sup> century US ‘big business’

# Alternative history?

- ‘Genealogy’ of accounting and the ‘examination’ (Hoskin & Mcv *AHJ* 2000) as disciplinary ‘power-knowledge’ (Power, *ARS*, 2011)
- C 13<sup>th</sup> invention of DEB as precipitate of new textual orientations in new universities
- USMA West Point after 1817—new ‘grammatocentric’ ways of learning, examining and grading by elite engineers
- From examination marks to accounting \$
- Examinations as ‘institutional rational myth’

# Alternative history? (cont.)

- 1830s Springfield Armory and ‘time and motion’ standards long before Taylorism
- 1850s US railroad organization and accounting
- *constructing* objective performance and ‘calculable persons’ (Miller & O’Leary, AOS, 1987; Miller, AS 1992) in new business organizations
- new ‘grammatocentric’ practices and discourses of norms, performance and accountability (e.g. Hoskin & Mcv AHJ 2000)

## Alternative history? (cont.)

- internalized systems of control that ‘quietly order us about’ (Foucault, quoted by Megill, 1979).

### ***New power of accounting then permeates:***

- external financing and accountability
- ‘Accountancy’ as a new profession
- inexorably extended beyond ‘big businesses’ to networks of financial markets, regulation, and now international financial reporting standards (IFRS/ US GAAP)

## Alternative history? (cont.)

- Extended beyond listed companies, e.g. into Oxford colleges (Jones, *ABR*, 1992); Lloyd's (Gwilliam *et al.* 1992; *AH* 2000)
- beyond business sphere into NPM and WGA
- Now 'spawning': how to construct most meaningful 'performance index number' (e.g. ROI) in a world of increasingly powerful indices that give (illusion of?) control at a distance (Rottenburg at IPA 2012: e.g. IQ (intelligence); HPI (poverty); HDI (development); RoL Index (rule of law); GII gender equality)) as well as providing 'proxies' for empirical research?

# Alternative history? (cont.)

This new power of ‘human accountability’ had **not** ‘evolved’ in BIR even as accounting embraced technological advances in assets and changes in the organization of and the accounting for labour costs (‘piece rates’ vs ‘day rates’) (Hoskin & Mcv *AHJ* 2000)

- **Newcastle mines** (Fleischman & Mcv *ABR* 2002)
- **Carron Co ironworks** (Bryer 2006; cf Toms *AOS* 2010; Fleischman & Mcv 2012)
- **Boulton & Watt** (Fleischman, Hoskin & Mcv *ABR* 1995)

# Mining in Newcastle area 18<sup>th</sup> / 19<sup>th</sup> century

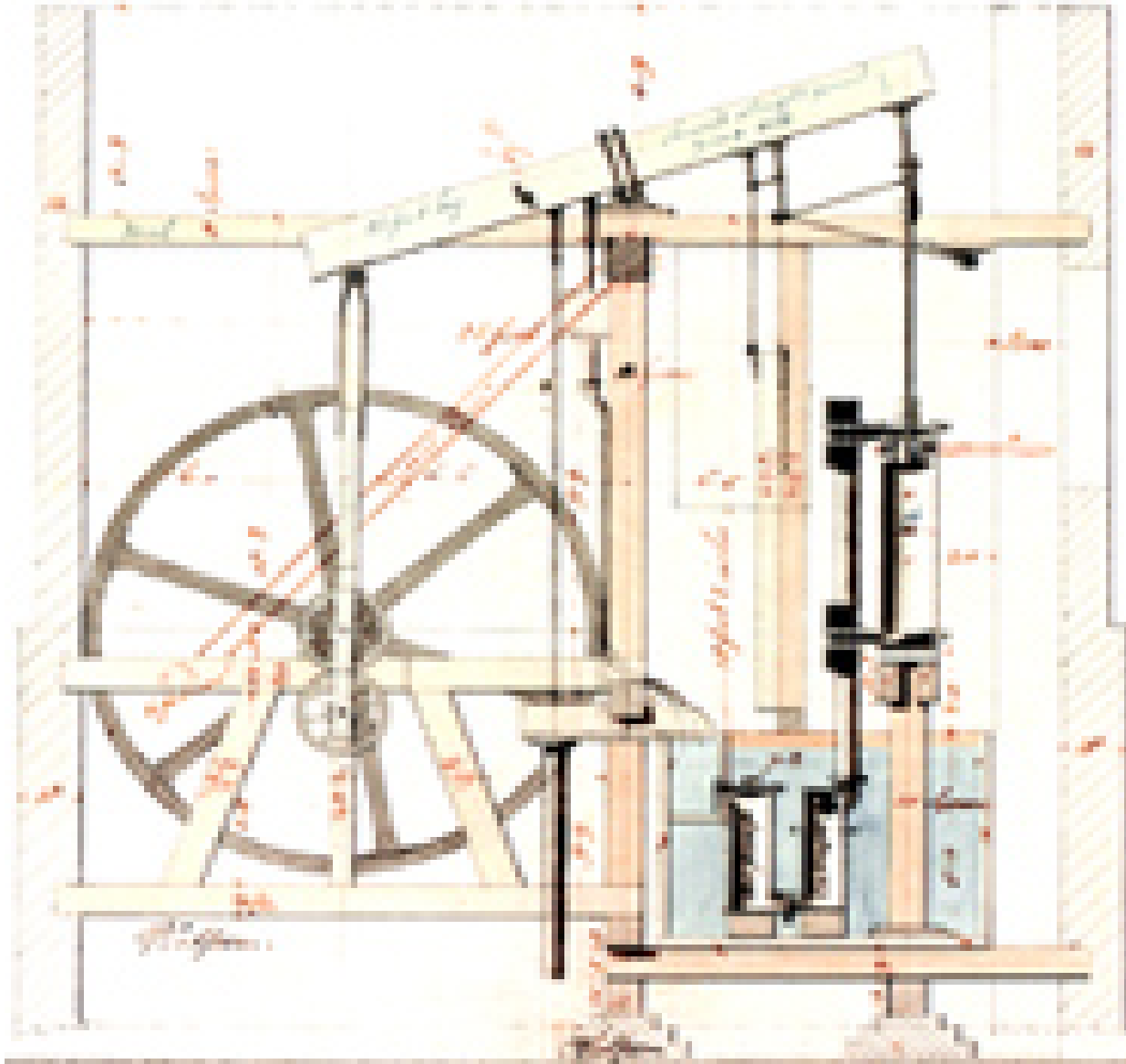




# Keeping well away from Carron Ironworks..... c 1790



# Boulton & Watt steam engine



# Improving modern FAT?

- Has audited, DEB, accrual accounting become a 'taken for granted', and now global, institutional rational myth?
- How much is myth and how much is rational? How much is power and how much is knowledge?
- Penman (2011) and 'back to a balance sheet that won't bite you + RI' to challenge stockmarket price!
- But needs 'good accounting' (Ryan *ABR* 2012): so.....

# Improving FAT? (cont.)

- Penman's simple remedies: historical (or transaction) cost for operating not speculating; 'no intangibles'; and FV only for financial activities (= 0 NPV)
- **BUT** avoids e.g. leases, pensions, fixed asset revaluation, 'deferred tax'---goodwill?
- changes in discount rates? (cf Ryan *ABR* 2012 )
- 'replacement cost' for forecasting 'sustainable margins'? And price regulation? And hedging?

# Improving FAT? (cont.)

- Penman (2011) avoids accounting for business combinations (where GAAP includes intangibles at FV)
- suspicious of deferred revenues and ‘big baths’ (‘cookie-jar’ accounting)
- **but** revenue and profits must be ‘earned’
- Just another stirring of the accrual accounting pot? (McV 1983) cf. deprival/relief value? (Horton *et al.* ABR 2011)

# Improving FAT? (cont.)

- Has conventional accounting model really outlived its usefulness (cf. ICAEW 2009; Lambert *JAE* 2010)?
- Embedded institutional familiarity: so unknown consequences of change.....
- Even if optimal *were* known, still subject to QWERTY transition-cost problem...and to ‘second best’ .....at least for now (David *AER* 1985; Mcv *ABR* 2010)
- Thanks to C.L.Sholes and Remington(1873)



# The future of FAT? 1:China?

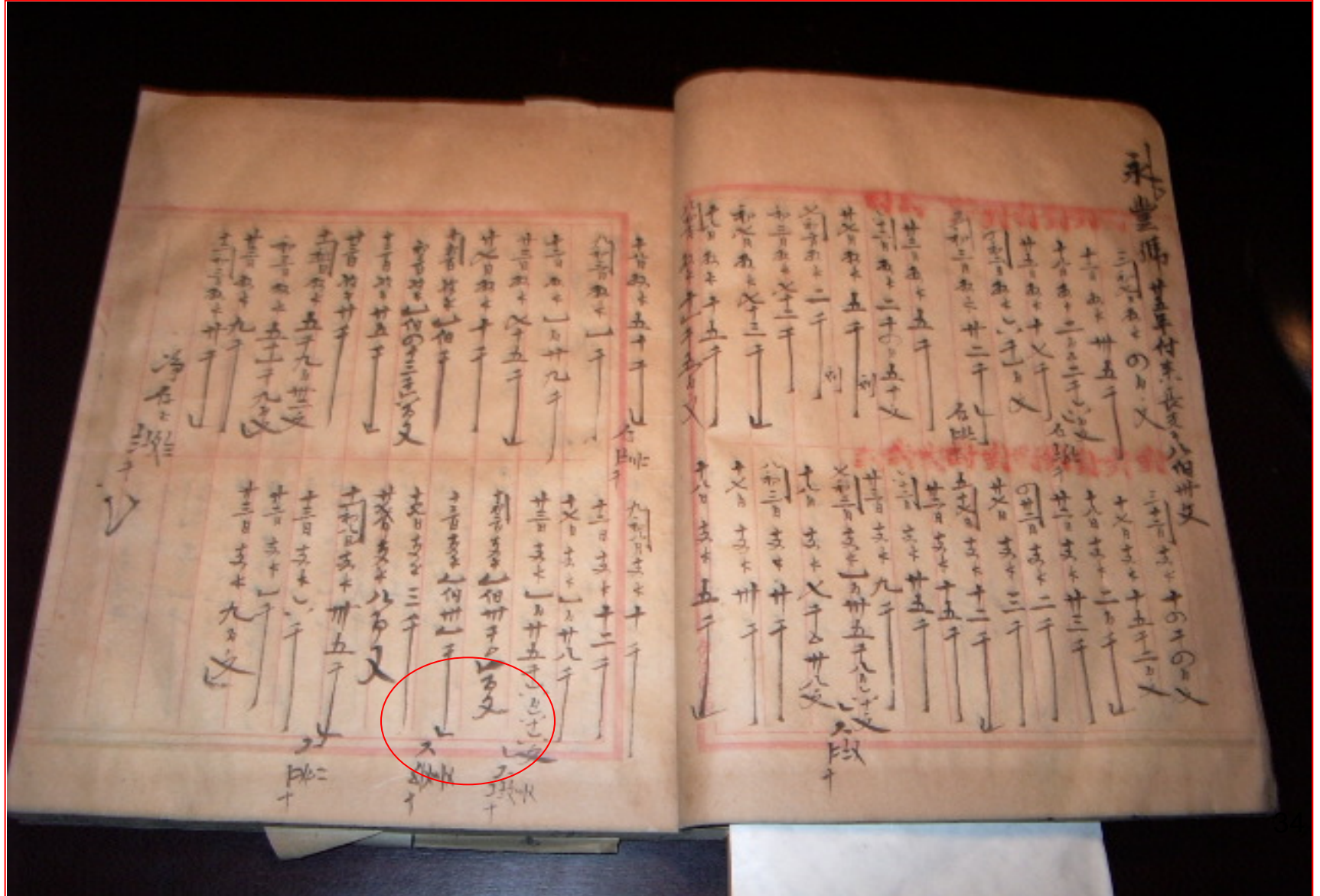
- China now nearly at full 'Anglo-US' IFRS
- No inherited accounting and management educational or professional tradition before 1978 'Reforms & Openness' of Deng Xiao Ping...
- But indigenous mercantile and bank accounting (without **full** DEB) appears in 18<sup>th</sup>-19<sup>th</sup> centuries (Hoskin & Mcv 2011; Yuan, Mcv & Ma, 2012)
- Business culture (e.g. family and regional social networks; *guānxi* 关系)? Changing?





Tǒng Tài Shēng: A page from the silver account for Dàoguāng year 22 (i.e. starting in 1842AD)

Carefully structured books with 'in' in top half and 'out' in bottom half; anti-fraud 'infill' strokes; red 'chops' for checking/posting; *Sūzhōu mǎzì* [苏州码字] numerals (a customer account for the main TTS store from *Dàoguāng* year 26, i.e. starting in 1846AD)





# The future? 1: China (cont.)

- Politics (national and international) of China becoming 'global'? Now has IASB Board member etc. and government-supported growth of 'indigenous' audit firms. Next Big 5 firm will be Chinese? (Deng & Mcv 2012)
- Has secured change in related party disclosures in IAS24 to exclude 'government related entities'
- Cf. Russia and 'translation' of international auditing standards (Mennicken, AOS, 2008).
- What if 'Washington consensus', neo-liberal model does not extend to BRICs?
- How will that reshape accounting and finance and its professions?

# Watch these names...the Chinese CPA firms that now have 'H-share' licenses

- 立信会计师事务所 *lìxìn kuàijìshī shìwùsuǒ*  
**BDO CHINA SHU LUN PAN** Certified Public Accountants  
LLP
- 天健会计师事务所 *tiānjiàn kuàijìshī shìwùsuǒ*  
Pan-China Certified Public Accountants
- 大华会计师事务所 *dàhuá kuàijìshī shìwùsuǒ*  
Da Hua Certified Public Accountants  
[Member of BDO international network]
- 京都天华会计师事务所 *jīngdūtiānhuá kuàijìshī shìwùsuǒ*  
**Grant Thornton** China

# The Chinese CPA firms that now have H-share licenses (cont)

- 信永中和会计师事务所 *xìnyǒngzhōnghé kuàijìshī shìwùsuǒ*

**ShineWing** Certified Public Accountants

[participates in Praxity international network]

- 国富浩华会计师事务所 *guófùhàohuá kuàijìshī shìwùsuǒ*

Crowe Horwath China CPAs

- 中瑞岳华会计师事务所 *zhōngruìyuèhuá kuàijìshī shìwùsuǒ*

RSM China Certified Public Accountants Co. Ltd

- 大信会计师事务所 *dàxìn kuàijìshī shìwùsuǒ*

Daxin Certified Public Accountants

[Member of PKF international network]

**PLUS the Big 4 JVs (now under threat)**

# The future? 2: CSR reporting?

- Within or beyond accounting? (ICAEW 1992; Mcv 1997; ICAEW 2004)
- ‘Integrated reporting?’ (e.g. Prince of Wales’s sustainability project)
- Real change vs. ‘greenwash’? (Hopwood AOS 2009; Mcv & Chen, AAAJ, 2010)
- Long-term business sustainability needs to reflect changes in politics and society (Giddens, 2009; Eccles et al. 2012)
- Essential for human survival? (Guo et al. 2012)
- Increasing interest by Chinese government, in SOEs and among Chinese researchers

**“Accounting history: ‘rational evolution’ or ‘just one damn thing after another’?”**

I hope I have shown why I have learned that understanding the current and potential role of the ‘rational myth’ of accounting within modern firms and in capital markets also requires understanding comparative international accounting history.....

- Accounting history is more than ‘just one damn thing (or even just one person) after another’ (but cf. QWERTY: Paul *AER* 1985)
- But ‘rational evolution’ privileges response to external needs over **performative** role in constitution of new possibilities
- Initially ‘supplementary’ practices later become central in new discourses that enable new forms of economic, political and social interaction---and their **subversion** (Hoskin & Mcv AHJ 2000; Ezzamel & Hoskin CPA 2002)



# Research and Impact?

- Generally, well educated practitioners, policy makers and public are probably more responsive to the value of historical insights (e.g. Niall Ferguson on TV...)
- But most academic accounting researchers (especially in US) trained towards narrow, specialist quantitative focus; and even distort vocabulary (e.g. 'archival research').
- China etc. now adopting US 'journal rankings
- At SUFE non-US/Can grades:
  - 'A' *none*
  - 'B' *AOS ; JBFA*
  - 'C+' *none*
  - 'C' (lowest recognised): *Abacus; ABR; MAR*
- Nowhere: *EAR; BAR; AAAJ; CPA; AHJ or other history journals.....*

# Research and Impact (cont....)

- Is UK more eclectic? (Ashton et al. *BAR* 2009) but cf. initial UK ABS rankings (Unerman at BAFA, 2012)
- Standard setters wedded to triumph of rational ‘concepts’ over historically inherited ‘conventions’ (FASB/IASB 2005; Bromwich et al *Abacus* 2010)
- Is value of audited financial accounting more at ‘network’ level (like traffic signals) rather than at level of individual firm? (Edwards *The Accountant* 1938; Mcv *ABR* 2010) e.g. ‘regional’ cost of capital more than individual firms?
- Very difficult economics...and intertwined with social and political priorities.

# Is that it.....?

Remember Wittgenstein:

‘My work consists of two parts: the one I have presented here plus all that I have *not* written. And it is precisely the second part that is the important one.’

(in a personal letter to Ludwig von Ficker, editor of the Roman Catholic, existentialist periodical *Der Brenner*, in 1919)

Thank you.  
Questions and observations...?

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