

# [Accounting theory and history accounting essay](https://assignbuster.com/accounting-theory-and-history-accounting-essay/)

Accounting has evolved since it was first developed and has continued to evolve. The aim of this essay is to explore and discuss why accounting, both financial and management has changed over the last millennium. In order to achieve this aim an in-depth approach will be taken into the origins of accounting, its purpose and need. This will mean examining history papers which are evidence-based but are intertwined with value judgement. Many alternative theoretical and practical explanations are offered in literature for the development of accounting over time. These course literatures will be evaluated and there theories will subsequently be accepted or rejected.

In order to explore the question and because the definitions provided by accounting bodies are themselves are subject to change, it is crucial to first define accounting and its purpose. The purpose of accounting is to provide information based on relevant data that aids users in making economic decisions.

Financial accounting is designed mainly to produce financial reports which provide information regarding the firm’s performance to external users such as Tax authorities, Investors, Customers and Creditors. Financial Accounting is highly regulated in order to ensure they have certain characteristics. These characteristics enhance the usefulness of the financial reports to users. These characteristics are relevance, comparability, timeliness, fairness and objectivity.

Management accounting is used to prepare accounts and reports that provide accurate and up to date information that allows management to make decisions.

Accounting developed as people needed a method of recording their assets and property. If property was recorded and accounted for, it would be easy to prove legal ownership. Accountancy has been around for thousands of years. Professor L. Plunkett of the College of Charleston calls accounting the “ oldest profession”

In this millennium there have been countless changes and developments in accounting. From more primitive methods of simple accounting for property and assets, in order to record for evidence of legal ownership to a complex regulated form.

Management Accounting

“ British Entrepreneurs and Pre-Industrial Revolution Evidence of Cost Management” a paper by Richard K. Fleischman and Lee D. Parker examines the use and developments of cost accounting in 1760 to 1850. The four main areas looked at in cost management will be: cost control techniques, accounting for overhead, costing for routine and special decision making, and standard costing.

These firms used cost data to control raw material input materials. The iron firms broke down costs using raw material controls, whilst taking into account the differential costs of mining and smelting. Textile firms were concerned about the profitable raw mixtures and the cost of raw materials input. Marshall textile firm employ the practise of using performance cards, which is an effective method and is still used by firms today. Performance cards are used daily to monitor and control expenses.. These management accounting practises benefited the business greatly. It allowed marshal to be cost effective and efficient by minimising costs. Gregs was another textile firm which kept wage and expense books to calculate control costs. This helps to identify trends, weaknesses and areas for improvement. For example they experienced losses in 1829 and where able to identify and attribute these to heightened production costs and outdated machinery.

The textile and iron firms were in a highly competitive market, and so dependent on a market-driven pricing structure. This gradually changed as with firms using product costing to aid in determining the optimum level of output. Boulton & Watt and Wedgewood were able to calculate overheads such as factory costs, fixed costs and selling expense. This enabled them to factor these costs into their selling prices.

“ Industrial Revolution entrepreneurs employed cost analysis to support vertical integration and product line decisions” (Fleischman 1990, P367) Decisions such as capital equipment purchases and mineral field leases where taken after careful consideration of costing of alternatives. This enabled them to justify and make potentially better decisions as the quality of information on which to base the decision on was better.

“ The use of standard costing was associated with an awareness of the cost saving available from appropriate inventory control procedures.” (Richard K. Fleischman et la 1990) Standard costing saved the time of actually having to accumulate actual inventory costs. This is beneficial for firms as they can create standard costs, which allow the business to: identify and eliminate obsolete items, budget and compare with actual costs, estimate a price more easily than calculating a price based on actual cost, create forecasts for production.

An Archivist responds to the New Accounting History: The Case of the U. S. Men’s Clothing Industry is a paper by Thomas Tyson that uses factual evidence on the history of accounting to examine the changes. It focuses mainly on the men’s clothing industry. Miller and O’Leary (1987) implied that “ the principle of standard costs made it possible to attach to every individual within the firm norms and standards of behaviour… Standard costing and budgeting made possible a pinpointing of responsibility for preventable inefficiencies at the level of the very individual from whom they derived” this is true to an extent and can be seen in the British Railways Industry’s costing system. BRM failed to budget or use standard costing till they were forced to do so as a result of declining profits. This fail mean preventable inefficiencies were not prevented.

Hopper and Armstrong state the reason for these changes to management accounting being due to the direct result of firms struggling. “ Accounting controls were not a consequence of economic or technological imperatives, but rather were rooted in struggles as firms attempted to control labour processes in various epochs of capitalistic development.” (H&A 1991, P. 405)

Along with changes in accounting, there came changes in innovations in management. “ Scientific management sought to establish itself a right to interfere in people’s lives. This right was eventually to be taken over by an army of techniques of social and economic life of the enterprise… the project of scientific management helped to render apparent and remediable the waste lying deep within the every move of the worker.” (Tyson. T, an archivists response to new accounting history) it is generally considered that Tysons paper is flawed.

Cost accounting in the shipbuilding, engineering and metals industries of the West of Scotland, ” The Workshops of the Empire”, C1900-1960 is a paper by A. I. M. Fleming, S. Mckinstry and K. Wallace. The paper examines the nature and developments of costing systems employed in the shipbuilding, engineering and metals industries of the West of Scotland between the years c1900-1960. These developments can be seen as a progression from the cost management practises employed in textile and iron works examined in the previous paper, adapted to different industries.

There were developments necessitated by the fact that most work was contract-based or job based and so required a different method of cost accounting. Standard costing and budgetary control were rejected as a result of scepticism over the relevance of Taylorism and scientific management to the area’s industries. As many of the jobs and contracts were unique, this may not have been a bad thing.

The ship building industry split the ships costs into three main components, Hull, Boilers and Engine. Each had a separate cost-book which recorded direct wages and materials. This system allowed a comparison between the estimated direct costs and actual direct costs. A detailed wage analysis book was kept, separating wage cost for the three main components (hull, engine and boiler). The wage bill for each component was also split into separate categories e. g. direct workers, class of workman, piece work-based etc. This allowed them to maximise efficiency in terms of labour costs as staff and materials were already supervised. This also reduced the risk of theft. “ There therefore existed a system that enabled the tracking of costs versus estimate at prime cost level on a progressive basis as contracts proceeded.” (K. Wallace & Parker 2000, P363)

The British Railway Industry tended to sell in fixed price contracts. The Cost and Weight Book recorded the cost associated with each of the major component of the locomotive e. g. Boiler, firebox etc. This book had a strict template each major component was printed on the left and separate costs where printed at the top. This format allowed comparison between different contract cost and understandability. It also allowed for good estimation for future contract costs. This format has changed little in modern management accounting. A failure of the company was to not fully utilise this valuable information as they did not use budgeting, standard costing or marginal costing. “ Costs were not analysed by department or works.” (K. wallace and Parker 2000) Not until the firm began to decline in 1960 did they introduce a form of “ simple” budgeting. This failure to budget was a weakness that was eventually addressed but cost the firm potential cost saving efficiencies.

“ The Industrial Revolution versus the Managerial Revolution: Distinguishing Difference in Accounting Practices” a paper by Keith Hoskin and Richard Macve discusses the role of accounting as a producer of Modern Managerialism. “ The accounting practises of writing, examining and grading came to structure human activity for those who learned to learn under them, it is understandable how accounting could discover a new role in the business context.” (Hoskin & Macve, 1993, p 9) This statement indicates an evolving role of accounting in business and influencing the structuring of human activity. This theory was seen being employed at Springfield Armoury. The armoury generated a large quantities of accounting information “ costs were tracked, records of production were kept , full-cost estimates made for pricing decisions, including the application of charges for interest and depreciation.” (Hoskin & Macve, 1993, p 9) This was done in order to form a “ complete system of accountability.” This was an important step along with the introduction of charges for interest and depreciation.

This paper relates to economic rational theory which can be used to explain the developments in management accounting. People make choices based on their “ rational outlook, available information and past experiences.” (Investopedia online, http://www. investopedia. com/terms/r/rationaltheoryofexpectations. asp#axzz1g2suXeki)

As the result of highly competitive markets and rising labour costs reduced profits, firms developed cost management techniques, such as: cost control to control and break down the cost of individual materials used, accounting for overheads which allows firms to factor costs such as fixed and factory costs into the selling price and standard costing which allows budgeting and comparison with actual costs.

An example of economic rational theory is the British Locomotive Company who learned from past experiences of losing cost saving for not using budgeting, standard costing or marginal costing and as a result they introduce a form of “ simple” budgeting. Economic rational also drove the changes in monastic houses. Changes were introduced after rational outlook, weaknesses and past failings were identified were taken into account. Albion Motors and Monastic houses and Estates have also made changes based on their economic rational.

These changes represent the evolution of management accounting over the last millennium. In the paper “ The Industrial Revolution versus the Managerial Revolution” we see significant changes to management accounting because of a need to control labour and maximise labour efficiency. This is because of the abolition of slavery which means that employees must be paid. This means employees must maximise labour effectiveness and efficiency. This led to the managerial revolution. Springfield armoury used labour control to increase productivity and reduce costs.

We see a development in cost management practises in the in “ British Entrepreneurs and Pre-Industrial Revolution Evidence of Cost Management” paper. Fleischman states the lengthy period of decline of market prices that affected the iron industry firms from 1808 to 1830. “ The struggle to cope with falling market prices caused firms in the industry to undertake careful investigations of their iron-making costs” (K. wallace and Parker 2000, P368) The decline motivated these developments in cost management. They were brought about by a need to adapt to other changes in the market and economy at the time. The practises in use at the time were inadequate and out-dated. The developments allowed them to better identify weaknesses, which had the effect of increasing production, efficiency, decreasing waste and helping set a better selling price.

In Cost accounting in the shipbuilding, engineering and metals industries of the West of Scotland, “ the Workshops of the Empire”, C1900-1960 we see further development of cost management system. The reason for these specific developments was that shipbuilding and railway jobs where contract based and so it would not be ideal to use standard costing. It was necessary to use another method of cost accounting.

Financial Accounting

The first paper that will be discussed is “ The development of financial management and control in monastic houses and estates in England c. 1200-1540” by Alisdair Dobie.

The changes focus mainly on the internal function of a monastery. These changes are necessitated by “ changing influences and pressures, economic and religious which arose from 1200 onwards.” (Dobie, 2008 P. 2)

Monastic houses where not all the same, there were different orders. Each was governed by different sets of rules. New orders were formed when there were perceived weaknesses in established orders. These new orders introduced additional sets of rules. “ Each Benedictine house was to a large extent autonomous and responsible for its own affairs.”(Dobie 2008, P3). This statement indicates a degree of accountability within the houses. As a result of failings due to Benedictine self-regulation, new orders emerged which lead to each house forming a subsidiary part of the whole order. This meant that each separate house was subject to inspection, regulation and control from the order as a whole. These inspections were a form of audit from the order on the house. “ Changes in management might vary from order to order and house to house, depending upon individual situations, relevance and needs.” (Dobie, 2008 P2) Changes were introduced after weaknesses were identified, in order to continued improvement and bring together all houses from the same orders to using the same set of rules.

Financial management and control changes can be broken down into three categories: the safeguarding of the assets of the house; the exploitation of its resources; and, the efforts to ensure that all resources were used effectively and efficiently. Safeguarding the assets of the house meant physically securing and maintaining them against for example “ encroachment, diminution or alienation.” (Dobie, 2008 P4) Exploitation of resources meant making full use of land and estate. This was a response to failing grain prices and rising labour costs. Efficiency and effectiveness referred to the “ efficiency and effective use of resources by the house.”

Other major developments during this time were the standardisation of accounts which allowed comparability and relevance, accounting was also taught at university from the fourteenth century onwards.

A significant development in the early millennium is seen in renaissance Italy. There was a rise in trade and banking. A form of double-entry book keeping was already being used by banks to keep track of debtors and creditors.

Luca Pacioli, the Perfect Accountant is a paper by Dr F G Volmer, University of Limburg, which discusses the life and works of Luca Pacioli. Pacioli’s work has had a great influence on accountancy. His publication “ Summa De Arithmetica” was widely recognised as a giant leap forward for double-entry book keeping. Pacioli’s Summa was a conceptual framework of best accounting and business practices. Summa was written in Tuscan and Venetian dialects. Pacioli used these instead of Latin to allow the educated and non-educated to benefit equally from his work. Pacioli’s conceptual framework is very similar to the FASB’s 1976 conceptual framework.” the principles of systematicalness, consistency and reliability then emerge. “ Every item must be systematically and carefully recorded in the inventory with all countermarks, full names and in as much detail an as possible…” (Volmer P7)

200 years before Pacioli Italians traders began using Arabic numerals in order to keep track of profits instead of roman numerals. This was an important change. Arabic numerals were easier to understand and easier to use in an accounting format. This change is a step in the direction of modern day management accounting where English numbers which are similar to Arabic numerals are used for bookkeeping.

Rouse and Rouse sum up Pacioli’s innovations under different headings: The use of alphabetical order “ as a means of arranging words and ideas” This development of a new visually orientated layout created an easy to use and understand template for double entry. “ Pacioli’s fully-developed double-entry system, with bi-lateral layout and systematic cross-referencing of debit and credit, was a particular form of the new general textuality.” This bi-lateral layout of the double-entry system is still in use to this day. It allows cross-referencing of credits and debits which is particularly useful for to banks. This partially answers the main question as to why management accounting has changed over the last millennium. Pacioli’s influential work resulted in necessary positive changes in accountancy. He introduced three books of record: the ledger, the memorandum and the journal. These required debit and credit transactions to be balance. Books that did not balance usually indicated an error.

Dowlais Iron Company: Accounting Policies and Procedures for Profit Measurement and Reporting Purposes by J. R. Edwards and C. Baber is a paper that shows development in both financial and management accounting.

DIC implemented a robust system of management accounting. Book-keepers were employed by DIC to maintain the books of accounting on a strict double entry basis (a double-entry system developed by Luca Pacioli). This was a family business, but the business was treated as a separate legal entity. This is common in modern businesses as it allows limited liability for the owners. This can also be seen when personal non-business transactions undertaken by owners were properly accounted for through the relevant partner’s current account.

DIC adhered to three out of the four main fundamental concepts of accounting when preparing financial statement. These were prudence, going concern and consistency. Less emphasis was placed on the use of the accruals concept, “ especially in its application to the treatment of capital expenditure” (Edwards and Baber 1979 P142) This is not unusual for businesses in the 1800s and was mainly due to a perceived conflict between the accruals and prudence concepts, with the prudence concept being considered more beneficial. This contrasts with a more balanced use of both concepts currently used today. The use of these concepts shows a development of financial accounting within the organisation.

DIC’s system of capital accounting is said to have helped the firm successfully grow to an immense size. This was funded through internal finance. The reliance on internal finance led to problems during the 1850s. A succession of trading losses drained the reserve funds. This led to DIC reorganising the Works and turn to external finance. Profit returned to acceptable levels in the mid-1860s

We see in the private ledgers that there were summary balance sheets till 1861 this suggested that there was information that the management was attempting to hide. From 1861 onwards the company accountant adopted the policy of adding the relevant narrative explaining each total. This policy is still in use today and shows further development in financial accounting at the time. Companies summarise and disclose significant and relevant information relating to the figures in accounts in the notes. This would have been done to enhance the understandibility, allowing for totals to be broken up and examined.

The financial reporting practises of British municipal corporations 1835-1933: a study in accounting innovation by Hugh M Coombs and John Richard Edwards is a paper in which we see the government fulfilling the role of a regulatory body. Developments were mainly in response to “ growing central government concern with corruption, mismanagement and lack of accountability.” (Combes & Edwards, 1995 P2) This in short led to the introduction of the Municipal Corporations Act 1835. This act attempted to ensure proper regulation of municipal corporations. “ The borough treasures was obliged to: make “ true accounts” of all transactions, make books available for inspection by the councillors, to prepare an account for the council as and when required, to submit accounts to auditors elected by the ratepayers, to sign and cause to be printed a full abstract of his accounts’, and to make the accounts available for inspection by ratepayers.” (H. M. Combes et la, 1995) This shows a tightening up of regulation and an increase in accountability. It is a significant development in financial accounting.

During this time we also see a move away from cash accounting to accruals. The accruals concept had previously been viewed with scepticism as seen in Dowlais Iron Company as it conflicted with the prudence concept. Cash-based accounting was at times restrictive and its disadvantages far out way its advantages. Accruals based accounting on the other hand: “ protects against negligence and irregularity by recording every step of a transaction, enables the statement of an entity’s profit and loss and financial position; it records values; and it provides a stable and homogenous basis for statistics.” (Combes & Edwards, 1995 P2)

The second development during this time was the use of the double accounting system of financial reporting. “ This system is able to combine the attributes of charge/discharge accounting with commercial accounting.” (Combes & Edwards, 1995 P3) It is a combination of stewardship orientation and profit calculation orientation. The advantage of this system is that it would prevent anyone from being misled into assuming a connection between expenditure appearing debited in the capital account and the actual value of works associated with that expenditure

In the paper “ Engineering culture and accounting development at Albion Motors 1900- c. 1970” by Sam McKinstry we see the relationship between Albion Motor’s accounting systems and its engineering-orientated culture. This paper shows changes in both financial and management accounting. Albion motors used a well-developed double entry system, a system no doubt derived from the work of Pacioli. Depreciation was also charged on machinery, by assessing there useful life. Depreciation ranged from between 10% and 33. 3%. Albion motors also used one of the first firms to use full accruals accounting, which is a clear change as firms had previously preferred to us prudence. Full accounts were only produced every financial year, as was a full stocktaking. A plant register was kept and maintained by the engineering department. This allowed for accountability and reduced the chances of fraud in the depots.

Albion motors employed a highly skilled but unqualified a company secretary and cashier, although this was not uncommon at the time when they became a public company they employed a chartered accountant. This is a significant development as the qualified accountants’ involvement reinforces the reputability of the company’s financial accounts. It is now essential for the public company accounts to be produced by someone who is qualified to do so, as not to do so would lead investors to question their accuracy. The non-qualified employee responsible for all accounting from 1914 until 1950 was succeeded by a chartered accountant. This emphasizes the reputation and influence of the profession of accountancy. It is around 1950s that there is seen the emergence of the financial accountant. The need of the users of financial information is changing, the emergence of this new official role show that clearly. Investors’ confidence in financial reports is dependent on financial information having characteristics which are discussed in IAS 1. Financial information must be relevant, up to date, reliable and free from bias. The financial accountant is qualified to produce financial information that abides by these criteria.

“ Christie Malry’s own double entry” by B. S. Johnson: An interpretation as foucauldian disclosures a paper by Sam McKinstry that examines the work of the novelist B. S. Johnson. This paper discusses the idea that accounting can be used to convey certain information to certain people. In this case the issue that the Double-entry system only “ favours specific interests in society and disadvantages others.” (McKinstry 2006 P990) This directly disagrees with public interest theory which states that “ regulation is initially put in place to benefit society as a whole.” (C. Deegan & J Unerman 2006, P 65) This paper also takes into account and makes reference to the work of Luca Pacioli in double entry bookkeeping. Malry adapts the double entry system, converting situations in his life into monetary values and inputting these values as either debits or credits. This adaptation was particularly important in the context of British politics and Industrial relations at the time. “ these and other developments recharged and remorilised capitalism and retooled social democratise ideology and its politics.” (McIlorys and Campbells 1999, P 93).

Collectively these developments in financial accounting over the last millennium have resulted in financial accounting as we know it today. These changes where brought about by a change in the needs of users of financial information and the identifying of weaknesses.

We see many changes in the financial management of monastic houses and estates at the start of the millennium. “ The early Period of rapid growth in terms of new foundations was over, and the later Middle-ages witnessed the response of organisations in their age of maturity endeavouring to maintain their purpose and position.”(Dobie, 2008, P 3) Monasteries changed in order to adapt and survive the economic and religions pressures. These changed allowed them to maintain their positions survive the times. We see the introduction of an audit function and the changing of regulation to deal with the identification of weakness. Other factors such as the Black Death epidemic which impacted on the economy as well as the population influenced developments at the time.

Luca Pacioli developed the double-entry system used at the time by traders after identifying room for improvement this system is similar to the one used today. He also developed a conceptual framework of accounting best practises. Its influence can clearly be seen in today’s IASB and FASB conceptual frameworks.

In Dowlais Iron Company we see the implementing of a sophisticated financial reporting and management accounting system which complimented the financial accounting system. These systems allowed them to the size and success that they did. “ it is unlikely that any firm would have grown to the size and achieved the significance of DIC in the absence of a satisfactory system for recording both inflows and outflows of cash and other asset and movement of resources within the firm” (Edwards and Baber 1979 P139)

The Financial reporting practises of British municipal corporations in 1835-1933 show developments in the regulation, disclosure and controls in order to deal with corruption, mismanagement and lack of accountability in municipal corporations.

Political factors triggered by the two major wars impacted on both financial and management accounting. This can be seen in “ Engineering culture and accounting development at Albion motors” a paper by Sam Mckinstry. World War 2 led to the introduction of a War pension scheme, which is accounted for using IAS 19. We also see in 1950 the development of the role of the financial accountant. The role of the financial accountant is created mainly to provide credibility and reassurance to financial accounts. The financial accounting is qualified to produce accounts in accordance with regulations, to give a true and fair view of the firm’s finances in order to maintain investor confidence. This is a contribution factor in accounting being the reputable profession it is today. This is open to debate as it can be argued that this only gives the illusion of reputability. As seen in the collapse of Enron the financial reports approved by the financial accountants didn’t give a true and fair view of the organisation.

Possible theories into reasons for these changes are given in the demand for and supply of Accounting Theories: The Market for Excuses a paper by Ross L. Watts and Jerold L. Zimmerman. The paper discusses the question of why accounting theories are predominantly normative and why no general theory is generally accepted. “ It is generally concluded that accounting theory has had little substantive, direct impact on accounting practise or policy formation despite half a century of research” (R. L. Watts 1979, P 1) the theory of political process is one theorises the idea that individuals with power in government will attempt to gain wealth through the influence and prescribe accounting procedures that are in their own best interests. There is also the idea that as individuals have different interests there will be a number of different accounting theories on a single issue. This “ prevents general agreement on accounting history.”(R. L. Watts 1979, P 273) This theory can be proven by looking at the recent scandal involving MP’s expenses. MPs influenced the regulations on expenses in their own favour, in an attempt to gain wealth. There was also the issue that these individual expense claims were not made public but were leaked. This shows that disclosure requirements were inadequate, as a result of the identification of this weakness regulations have been tightened up. Another example of this is Ex-Prime Minister Tony Blair having tax-payers pay for his security when he travels the worlds for his own financial gains. Blair’s constitutional reform of the Human Rights Act 1998 when he was in power gives him this right.

“ The demand for “ public interest-orientated accounting theories depends on the extent of the government’s role in the economy.” (R. L. Watts 1979, P 275) a clear example of this is the adjusting of interest rates in order to help economic growth. Another example of this is the financial reporting practises of British municipal corporations 1835-1933, where there was corruption, mismanagement and lack of accountability. The government gave the illusion of acting in the public interest but from further analysis it can be seen that this legislation was a response to public protest. We can see that there was a degree of self-interest involved.

The motivation for all the developments of in financial accounting can be examined using Self-inte