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"We do not share the troubles of our trans-Atlantic cousins": The statutory framework for accounting in the UK and the US in the interwar period

Josephine Maltby
The York Management School, University of York

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"We do not share the troubles of our trans-Atlantic cousins"[1] : The statutory framework for accounting in the UK and the US in the interwar period.

"American experience has proved, we think, that the greater the degree of control exercised by governmental authorities over corporate accounting, the greater is the number of difficulties which inevitably crop up; for this reason it seems to us that the task of the American accountant must today be much harder than that of his British brother" (*The Accountant*, 21 May 1938 p. 690).

"The US financial reporting model places far more emphasis on extensive rules and regulations. This focus on detailed rules can encourage compliance with the letter of the law rather than the spirit" *Submission to the Treasury Committee's Inquiry into the Financial Regulation of Public Limited Companies by the ICAEW 10 April 202*

1 Introduction

The UK and the USA are generally bracketed together in discussions of corporate governance as exponents of the "Anglo-Saxon system". The distinctive features of the system are agreed to be an active stock market, "outsider" shareholders who are not involved in day-to-day management, the use of "exit" rather than "voice" (Hirschman 1970) when shareholders disagree with management, and an active market for corporate control which means that companies are vulnerable to hostile takeover. Because shareholders are outsiders, reliable published financial information is important if they are to monitor management performance, and accounting and auditing are therefore crucial elements of "Anglo-Saxon" corporate governance.

[1] *The Accountant,* 5 March 1927, p.330.

Comparative studies of international accounting practice emphasise the similarities between the UK and the US. For instance Nobes and Parker (2000) point out that the UK and the USA both have common-law systems, finance based on capital markets rather than credit, separate tax and financial reporting conventions, large accounting professions, a history of low inflation and little professional interest in accounting theory. The major difference between the two regimes is the system for regulating corporate reporting. In the USA, the Securities and Exchange Commission (SEC) was founded as a federal body in 1934 to oversee the financial markets, including the financial reporting activities of companies with a stock exchange quotation. Accounting standard-setting is carried out by Financial Accounting Standards Board (FASB) with powers delegated by the SEC, and the latter has the power to overturn FASB recommendations if it disagrees with them. There is no federal companies legislation. The UK has no counterpart for the SEC; accounting standards are set by the Accounting Standards Board, which is predominantly composed of members of the accounting profession. There is no federal counterpart in the USA to the UK Companies Acts.

As the SEC represents such a significant difference between the UK and US systems, an understanding of its genesis appears to be potentially important to a comparison of the two. Why did statute law play a more important part in the development of accounting in the UK, and why did the US profession fail to take control of accounting disclosure regulation? This issue of comparison has received little attention in accounting literature. Both Nobes and Parker (op.cit.) and Roberts et al. (1998) treat the divergence between the UK and US as an "accident" of history. According to Roberts (p25) "Much of the early UK company law legislation, including accounting regulations, was the result of financial crises or collapses of companies (…) In the USA the collapse of the stock market led to the creation of the SEC and increased accounting regulation to protect and encourage share ownership".

The differences between the UK and the US regimes were recognised by commentators in the 1920s and 1930s. This was a significant period for company regulation in both countries, as it included the establishment of the SEC and the debate surrounding the 1929 Companies Act. The comparisons drawn at the time between UK and US practice are of interest because of the light they throw on differing attitudes and priorities on either side of the Atlantic. A comparison also allows patterns of influence to be traced – ie the extent to which practice on one side was shaped by experience on the other. The evidence of this paper suggests that there was considerable awareness in each regime of the other's practice, and also that there were strong parallels between the issues faced by preparers and users of accounts. This makes the divergence of outcomes all the more interesting. The present paper concludes that the different legislative outcomes reflect differences in the relationship between the accounting profession, the state and the fractions of capital, and questions the ability of the "Anglo-Saxon" model to subsume all aspects of two sometimes divergent systems of governance.

The two quotations which preface this paper are separated by more than 60 years and a great deal of regulatory change. But they both reveal an awareness in the UK accounting profession of the differences within the allegedly homogeneous Anglo-Saxon model. They also show the UK profession pointing to the superiority of its own practice over that of the US. Another theme which this paper highlights is the way in which cross-national comparisons have been deployed to add kudos to the home profession. The Enron, WorldCom and Xerox scandals of 2001-2 in the US have all been used by the UK profession as evidence of its higher standards.

The paper examines the comparisons drawn by UK and US practitioners looking at each other's accounting. The main source of commentary is the professional and financial press of the period – in particular the US *Journal of Accountancy* and its British counterpart, *The Accountant.*. Neither was an "official organ" of an accounting professional body, although they took contributions from senior members of the profession, and although it cannot safely be claimed that they represented *all* points of view, they did provide forums for debate that were potentially open to all interested parties. As such, they offer interesting evidence about the debates that were conducted in the period.

The following sections of the paper outline the legal and professional systems in the UK and the US in the interwar period, and the accounting controversies which preoccupied users and preparers of accounts in the two regimes.

2 UK accounting regulation

There were four significant Companies Acts in the UK in the first half of the twentieth century - in 1900, 1907, 1928 and 1947[2]. The long gaps between the second, third and fourth Acts, at a time of rapid economic and social change, suggest reluctance to make drastic changes to the status quo, and this was indeed the case. The 1947 Companies Act did produce major changes to the regime under which companies operated, and in particular to their accounting disclosure; but over the

[2] The 1929 and 1948 Acts both consolidated legislation introduced in 1928 and 1947 respectively.

previous half-century, alterations had been very modest. Prior to 1947, the regime had been one of minimal disclosure, based on underlying assumptions that had changed little since the nineteenth century. Between 1862 and 1900, publication and audit of financial statements was voluntary for general limited companies ; company law did not impose any requirements. This freedom was only gradually curtailed in the first half of the twentieth century. The 1900 Companies Act required shareholders to appoint an auditor to report on the company's balance sheet, but made no stipulations either about the qualifications of the auditor or the content of the balance sheet. The content of the balance sheet was not prescribed, and there was no requirement to make public any profit and loss account.

A Company Law Committee was set up in 1925 under Wilfred Greene KC to carry out the first *general* review of company legislation since 1905[3]. It reported in 1926, and its recommendations were incorporated in the 1928 Companies Act, which was consolidated in 1929.

The 1928 Companies Act was prefaced and succeeded by debates about the needs of users and preparers of financial statements, in which certain criticisms of UK accounting recurred. The features of UK company accounting that attracted most criticism were its treatment of profit and loss disclosure and its requirements for reporting the performance of groups of companies. It was recognised that these were areas where US practice was in advance of (or at least different from) the UK. Contemporary discussions of the major shortcomings of UK practice and of the differences between UK and US practice are outlined in the following section of the paper.

3 Issues in UK accounting

This section identifies two major issues that were extensively debated both before and after the 1929 Companies Act, and then considers what motivated the regulatory treatment of them up to 1947.

Secret reserves

One of the most controversial areas in UK financial reporting was the issue of "secret" or "hidden" reserves. Such reserves arose when companies deliberately understated profits via the creation of excessive provisions - e.g. for depreciation, tax liabilities or doubtful debts. The absence of a detailed profit and loss account made it easier to conceal the creation of reserves; it also allowed companies to draw on reserves in years when profits were poor, and use the amounts released in order to maintain distributable profits. Secret reserves were highlighted in the 1906 case *Newton v Birmingham Small Arms Company* which hinged on the right of directors to create an "Internal Reserve Fund", which was not to be divulged to the shareholders. Justice Buckley defended directors' rights to understate in a verdict which was often quoted:

"Assets are often, by reason of prudence, estimated, and stated to be estimated, at less than their probably real value. The purpose of the balance sheet is primarily to show that the financial position of the company is at least as good as there stated, not to

[3] The Wrenbury Committee had been principally concerned with investment by aliens in British companies

show that it is not or may not be better" (*The Accountant Law Report* 7 July 1906, p.5).

This attitude continued to prevail, at least as far as company law was concerned, until the 1947 Act. It was generally well-known that companies routinely used secret reserves, and the accounting profession was happy to sanction this on the grounds of prudence. The practice was, however, called into question by the 1931 Royal Mail Steam Packet (RMSP*)* case. The managing director of the RMSP was convicted of fraud because his company issued a prospectus showing profits that were largely transfers out of previous years' taxation reserves. (See Brooks 1933 for a full description of the case). As outlined below, the case aroused criticism of secret reserves, but did not provoke any change in the legislation.

In order to prevent companies from creating and using secret reserves, it would have been necessary to require them to publish detailed profit and loss accounts, such that it was possible to see what had been charged against annual profit and also what transfers had been made from reserves to the profit. The 1928 Act made some minimal requirements for more extensive disclosure, but these did not radically improve the situation. Companies had to publish a profit and loss account, but apart from dividends and transfers to reserves, no details of profit and loss disclosure were stipulated.

Group accounts

UK companies were later than those in the US in forming groups, but by the 1920s the holding company form was beginning to be widely used. Some of the most important UK industrial groups were created in the first three decades of the century, including Lever Bros., GKN, ICI, GEC, Cable & Wireless and many others. The formation of groups, by merger or acquisition, served a number of purposes; it assisted in the rationalisation of troubled industries, it reduced competition, and it helped to create economies of scale. There was, however, no requirement for companies to produce consolidated accounts, nor any other information about the nature of one company's interest in another. It was thus impossible for users of accounts to know whether a reporting company belonged to a group, or to identify what proportion of profits in a holding company arose from a subsidiary's dividends rather than its own activities. Nor could related party transactions - e.g. purchases at other than market prices - be identified. Voluntary preparation of group accounts was extremely unusual; Edwards (1991) notes an isolated instance of consolidated accounts in 1910, but concludes that it had no impact on other companies' practices. Kitchen (1979) reviews a number of major groups in the 1920s and finds general reluctance to produce consolidated accounts, despite what he describes as "encouragement - even pressure". P&O, for instance, were censured by the *Economist* for "lack of candour", but still stoutly refused to produce a more informative balance sheet. (Kitchen, op.cit. pp. 101-2).

The 1929 Act made only minimal disclosure requirements. A consolidated balance sheet was not required; holding companies were required only to state in general terms how they had accounted for the results of subsidiaries. It was left to the 1947 Act to require all groups to produce consolidated accounts which fully explained the relationship between group members.

Debating the issues

Underlying the debates about both issues - secret reserves and consolidated accounts - was a conflict about the extent to which limited companies should be required to make their position public knowledge. The 1907 Act had created two classes of company, public and private, and the latter were in any case exempt from revealing their position. Public companies were those whose shares were traded on the Stock Exchange, which especially after the Great War attracted a growing number of small investors. The case was made that such investors needed to be empowered by being given reliable comparable information about their companies. Secret reserves were undesirable because they understated the company's profits and might lead to shareholders disposing of their shares at an undervalue.

The counter-argument was that the governance of a limited company was a matter of contract between its managers and its shareholders. Shareholders could use the company's meetings to question directors, and could if dissatisfied dismiss them. Published financial statements that gave detailed information about profitability were an intrusion into commercial confidentiality; rather than promoting shareholders' interests, they were liable to damage them by disclosing useful information to competing businesses. This was the burden of Lord Plender's evidence in the RMSP trial:

"I can conceive of cases in the commercial world in which it is properly unwise for directors to give to the world indications of how their business is progressing. If a shareholder liked to ask questions, then the chairman at the meeting could give to the shareholder such further information as he thought it proper to give" (Brooks, 1933, p.41).

Moreover, directors were appointed to run the company according to their skill and judgement, and shareholders should be prepared to delegate responsibility to them. Directors created secret reserves in order to maintain a buffer of profit for distribution in bad years. If they were prevented from doing this, and had to inform shareholders about the full amount of available profit, there was a danger that they would be pressed to make imprudently high distributions by shareholders who thought only of the short term. The responsibility of directors was to the limited company as an institution, not to shareholders who were liable to invest only for the sake of the next dividend and then exit the company. A correspondent to *The Accountant* (3. October 1925, pp. 537-8) summed up this view:

"Secret reserves when made in good faith by a board of directors are often in a company's best interest, and maintain it as a sound and permanent institution...Profits should not appear to fluctuate too violently in the interests of all concerned, with the exception perhaps of the merely temporary shareholder, or gambler in the company's shares, whom, I think, one need hardly consider in such a case".

The argument against consolidated accounts was partly a practical one: the members of a group were legally independent, and it was therefore misleading to prepare accounts that aggregated the assets and liabilities of different companies. In particular, it was misleading to creditors and lenders to imply that the assets of one member of the group were available to offset the liabilities of another. Additionally, again, the opponents of consolidated accounting insisted that financial statements should not disclose the internal workings of the company. Shareholders could use private channels to obtain the information they needed, as Lord Plender (quoted above) suggested.

The case for wider disclosure was made from a number of different perspectives. Financial journalists like Samuels claimed that accounts led to "obfuscation of the truth" (Samuels 1933, p.243) and impeded the operation of democratic control by shareholders. Labour MPs called for more information with the aim of empowering trades unions in their negotiations. The Labour MP and trades unionist Ernest Bevin asserted that "reserves(...) are really the unpaid wages of industry" (*The Accountant* 29 January 1927, p.141).The 1928 Liberal Industrial Inquiry called for "new and stringent" audit and accounting requirements for limited companies to promote "efficiency" (op.cit. 1928, p. 61). Standardised, detailed accounts would also be an aid to economic development by enabling government and industrial organisations to maintain better statistics. In 1925, a dinner of the Society of Incorporated Auditors and Accountants (SIAA) was told that

"They had a work before them, a great work, in factory organisation, cost accounting, statistics, standardisation of accounts, and in the matter of industrial relations between capital and labour. He felt sure that those tasks would need the closest Cooperation between the professional accountant and the economist" (*The Accountant* 7 November 1925, p.735).

But there was a division of opinion in the UK accounting profession. The SIAA supported reform, both before and after the 1929 Companies Act, and its president Henry Morgan was an articulate advocate of mandating wider disclosure, in order to alleviate what he called "the general lack of confidence" shown by the investing public (*The Accountant* 12 December 1931 p.781). But the Institute of Chartered Accountants in England and Wales (ICAEW) took a different line. Both before and after the RMSP case, the ICAEW insisted that "elasticity and not rigidity should be the keynote" (Lord Plender, *The Accountant* 12 February 1932 pp. 205). The crucial role in determining the extent of disclosure was not to be played by legislation but by the profession: "(F)ar more important than fresh legislation is the constant and unremitting exercise of intelligent judgement, supported by courage and common sense" (H L Hill's presidential address to ICAEW, *The Accountant* 7. May 1932 p.629). The ICAEW's leaders stressed that "any legislation which has the effect of limiting our discretionary powers may be calculated to undermine our status" (ICAEW president AE Cutforth, *The Accountant* 20. October 1934 p.545). It was the ICAEW view which prevailed. The ICAEW representatives who gave evidence to the Greene Committee all agreed that "the form of the Balance Sheet should as at present be left to the Directors and Shareholders", (*The Accountant* 19 September 1925, p.440) and Wilfred Greene subsequently emphasised that he had closely followed the ICAEW's recommendations in drawing up his report (*The Accountant* 13 November 1926, p.682).

The question that arises is why accounting disclosure was so underdeveloped in the UK. There was a vociferous lobby in its favour, but the leading accounting body was willing and able to discourage reform throughout the 1920s and 1930s. One possible way of understanding the peculiarities of UK accounting is to compare it with the USA in the same era, and see how accountants on either side of the Atlantic perceived the two regimes. The following section briefly outlines the institutional framework in the USA.

4 The Accounting Framework in the USA

The USA had no federal legislation in the nineteenth or early twentieth century which affected accounting. (See Previts and Merino 1998, p.187, Macintosh 1999 pp. 139-140). Disclosures to shareholders were voluntary, other than the fairly minimal requirements of individual states. This voluntary disclosure was in some ways more comprehensive than that mandated in the UK: in particular, US companies began to produce consolidated accounts as early as 1886 (Previts and Merino 1998, p.128).Merino and Neimark instance 29 out of the 30 largest trusts providing some income and asset data to investors by 1908 (Merino and Neimark 1982, p.37). These trusts would have been affected by a federal incorporation statute; the legislation was discussed with greater or lesser regularity for the first thirty years of the twentieth century but was never enacted (ibid.) They suggest that voluntary disclosure was deployed by large corporations in order to forestall government intervention.

It was only with the 1933 Securities Act and the 1934 Securities Exchange Act that legal regulation of accounting was introduced in the form of requirements for information disclosure where securities were offered for sale to the public, and the creation of the Securities and Exchange Commission to oversee securities trading.

Audit was not mandatory, although in 1932 the New York Stock Exchange required companies applying for stock market listing to undergo an independent audit. At the beginning of the century, A L Dickinson compared the UK and US audit markets:

"(A)nnual audits which in England are always the backbone of the business are comparatively few in number" (Jones 1995 p.92).

The absence of statutory audit requirements meant that audit was often lacking in independence - the auditor was an employee of the company - and the distinction between accounting and auditing was not well understood (Previts and Merino 1998, pp. 250-1).

The US accounting profession was relatively smaller than that in the UK. According to *The Accountant* (31 December 1938 p770) there was one accountant per 1850 people in UK, and one per 8500 in the USA. Neither country had a unified accounting profession. There were some 13 accountancy bodies in the UK between the wars (Matthews et al 1998, pp. 284-5), and disputes were not infrequent, as the various societies attempted to protect their market share and professional titles. But the situation in the US was even less harmonious. The American Institute of Accountants (AIA) and the American Society of Certified Public Accountants (ASCPA) were at loggerheads throughout most of the interwar years. The two bodies differed radically in their origins and understanding of their role. The AIA was the smaller in size, dominated by practitioners from the Eastern seaboard and the big cities, and heavily influenced by the British chartered accountants who had started arriving in the US at the end of the nineteenth century. It modelled itself on the ICAEW as a centralised professional association with a common examination structure for all its members and stressed the importance of audit as a key professional activity. The ASCPA, by contrast, had a federal structure, advocated devolution of examining and admissions to state level and perceived itself as closer to its "grassroots" membership of small practitioners, whose major interests were in accounting and business advice rather than audit. (See Previts and Merino 1998, p.244-5 and Miranti, 1990 pp. 115-127). Attempts to unite or at least harmonise the two bodies failed, and by the end of the 1920s relations between them were very poor. Previts and Merino conclude (p.246) that "from 1921 through the next decade ... the profession had no authoritative national voice". The effects of this disunity were felt when the process of consultation took place which produced the 1933/4 securities legislation.

5 Crises and controversies

The prevailing theme of the 1920s was the conflict between attempts to promote mandatory accounting disclosure, and the determination of the US profession to avoid outside regulation, in favour of voluntary codes of conduct. There was vocal criticism of US financial reporting during the 1920s by William Ripley, who called for better reporting in the interests of investors. He criticised leading US companies for producing either no financial data (as Singer did) or inadequate reports like Gillette and American Tobacco. Ripley was a Harvard professor, not a professional accountant, and he looked beyond the profession for a solution, calling for the Federal Trade Commission to mandate standardised disclosure by large manufacturing companies, in the interests not only of investors but also of "the State and the general public". (*The Accountant* 5 March 1927, p.345). George May, president of the AIA, admitted the validity of Ripley's criticisms, but resisted his conclusion that regulation was needed. May asserted that it would be "impracticable" to improve disclosure in the US through legislation. It should be achieved "through the cooperation of such bodies as the leading stock exchanges, the investment bankers and the commercial banks which grant credit" (*Journal of Accountancy* November 1926, vol. 42 p.323). Certainly banks were concerned about poor quality reporting and non-standard, ambiguously worded audit reports (Miranti, p.138), but they were unable to exert sufficient pressure to compel better voluntary disclosure. Professional accountants could be put under pressure by client management: the *Journal of Accountancy* complained about the "successors of Uriah Heep" whose "milk-sop certificates" were designed to avoid a positive or negative statement (November 1926 vol. 42, pp. 286-7). The New York Stock Exchange might have been in a position to enforce disclosure, but was reluctant to drive traders away by requiring high standards when other exchanges did not (Miranti p.142). As a result, the self-regulation advocated by May was ineffective. Protracted discussions about such issues as definition of accounting terms were inconclusive; internal struggles between the AIA and the ASCPA, and between practitioners and academics, detracted from efforts to produce any agreed statement of accounting principles.

Equally important was the absence of government support for intervention. President Coolidge's response to Ripley was that "it is difficult to determine what is a good and a bad stock" (Edwards, 1938, p.214). California and other states "even weakened their laws regulating new corporate securities on the ground that '(…)it has created unnecessary barriers to new business and modern financial operations'" (Edwards 1939, p.215, quoting *The Commercial and Financial Chronicle*).

The *Journal of Accountancy* prophetically commented in 1927 that "Perhaps the bull market which ran so long has made people lose sight of everything else. If there had been (…) an actual depression in business, people would have more time to devote to reform". (vol. 44, p.443). The "actual depression" which succeeded the 1929 Wall Street crash did indeed create pressure for reform, which was intensified by the

Kreuger affair, involving another major series of corporate collapses, in 1932. Events proved that voluntary disclosure was open to manipulation and abuse. Kreuger had persistently refused to reveal information to investors and decried the importance of financial reports. After his suicide and the discovery that he had been in effect operating a "giant pyramid scheme" (Flesher and Flesher, 1986, p.423), Price Waterhouse's report concluded that the combination of "complete secrecy" and "autocratic powers" (quoted in Flesher and Flesher, p.429) had made his frauds possible. The case for self-regulation and voluntary disclosure was seen as less and less plausible.

6 Securities legislation and the US profession

The 1933 Securities Act and 1934 Securities Exchange Act ran counter to the American profession's attempts to maintain a system of voluntary disclosure and self-regulation. The Acts required audited accounts for all companies whose shares were listed. They increased the potential liability of accountants to investors for negligence in reporting. Perhaps most disturbing for the accounting profession were the powers given to the Federal Trade Commission to establish accounting and auditing rules and to reject filing of financial statements if it disagreed with the accounting policies adopted. "The British Companies Acts had never gone that far" (Carey 1969, p.182). The accounting professional bodies were not formally represented at the congressional hearings which preceded the 1933/4 legislation. Various reasons have been suggested for this – the AIA's preference for dealing with other market players rather than with government, concern to avoid hostile questioning (Miranti, p.147), unpreparedness and an absence of policy ideas on the part of the profession

(Macintosh, p.148). The bills which appeared in 1933 “came as something of a surprise to the profession” (Carey 1979, p.254),

During the 1930s, the accounting profession went through a process of readjustment. Part of this was a reconciliation between the AIA and ASCPA, which culminated in the latter merging with the former in 1936. The threat of federal interference in accounting rule-making had persuaded them of the need for unity. Relations between the profession and the federal authorities - the FTC and the SEC - continued to be tense for some time for this reason, but the threat was never put into action. The accounting profession began to promulgate its own accounting and auditing standards, and relations with federal regulators, by the end of the 1930s, were on an easier footing. (Miranti, p.177).

7 Comparisons

The outline given in the preceding sections suggests a number of contrasts and comparisons between the accounting environment in the UK and USA. The UK had a long history of companies legislation which provided a framework, albeit a permissive one, in which the accounting profession could operate, whilst until 1933 there was no US federal intervention in company regulation. US accounting was more technically developed than it was in the UK, where consolidated accounts were rare and recent, but reporting practice in both countries ranged from the highly informative to the very reticent. Audit was better-developed in the UK, where companies legislation had created a market. The UK profession was more unified, or at least less divided, than that in the US, and had been able to play a far more active role on drawing up company legislation. As a result, although the UK profession had a longer history of outside regulation, it had also enjoyed more control over its destiny than accountants in the US, who, by the mid-1930s, were exposed to criticism and intervention by the FTC and SEC. In some respects, the US profession saw their UK counterparts as backward; in others, they saw UK legislation as a desirable model for the US to emulate. The following sections outline the reactions of commentators on both sides of the Atlantic.

8 UK views of the USA

The US practice most discussed in the UK throughout the inter-war years was the preparation of consolidated accounts. Gilbert Garnsey, a partner in Price Waterhouse, effectively launched the UK debate about the desirability of consolidated accounts when he read his paper "Holding Companies and their Published Accounts" to London members of the ICAEW in 1922. Garnsey pointed out that the consolidated balance sheet was "now almost universally adopted" by American holding companies (Jones 1995 p.159). Price Waterhouse's links with the US, as Jones suggests, may well have given Garnsey an awareness of the value of consolidated statements. Certainly the American example was often cited by advocates of wider disclosure. For instance Sir Arthur Lowes-Dickinson (formerly Price Waterhouse's senior partner in the US) praised US accounting "publicity" as far superior to the UK, and therefore more likely to remove the "distrust, friction and bad temper" prevailing between capital and labour (Lowes-Dickinson 1924). H B Samuels (op.cit.) quoted American commentators such as Berle, Brandeis and Ripley with approval for their advocacy of wider disclosure. W T Layton, later the chair of the Liberal Industrial Inquiry, reported after a visit to the USA that "the great increase in statistical information in America" was assisting in its economic revival (*The Accountant* 5 March 1925 p.521).

Some of the objections to extensive disclosure on the US pattern have been indicated above. Consolidated accounts were said to be potentially misleading because they obscured the legal reality; the requirement on companies to make extensive disclosure was in any case damaging to confidentiality and thus to shareholders' interests. None of the opponents of disclosure attempted to explain why it did not damage the US economy in the way they implied it would harm the British one. But they did frequently suggest that the US profession had suffered from over-regulation.

One element of this was a view that US reporting was unnecessarily detailed. *The Accountant* (30 March 1935 p.478) commented on the 34-page accounts of Bethlehem Steel "It reminds us of that form of examination question: 'Say all that you can about...'. Everything possible seems to have been said about the finances of the company". A London banker in evidence to the Cohen Committee in 1944 commented dismissively on the amount of detail provided by American prospectuses: "It won't be read, of course" (*Company Law Amendment Committee* 1944 p.263). The abiding Victorian view of a company as a private contract between shareholders and directors seemed to underlie this attitude: shareholders would ask directors for what they needed to know, and extensive mandatory disclosure was therefore inefficient.

But the more serious criticism levelled against the US was that accountants enjoyed less professional freedom. In a lecture on US accounting Prof T H Sanders of the

London School of Economics reported that “The accountant in the US enjoys something less of assured recognition and authority than is the case in England. The idea that accounting is what accountants say it is not a generally accepted tenet in America...Government officials, lawyers, economists, legislators, businessmen...have little hesitation in telling accountants what accounting ought to be”(*The Accountant* 22. April 1939 p.536). In an editorial the following week, *The Accountant* expressed concern over the “internal strain” that must arise where “Government exerts itself to direct and even to control accounting practice for the attainment of ends which are more political than scientific”.

There were signs that the UK was following the US at a distance; in 1939 the General Purposes Committee of the London Stock Exchange required holding companies to publish consolidated accounts. The ICAEW was lukewarm in its reaction; “matters of this kind should be dealt with by general legislation” and not by rules applicable only to listed companies (*The Accountant* 6. May 1939, p.608).(Although the intervention by the Stock Exchange seems to have given the ICAEW the impetus to back more extensive disclosure – see Maltby 2000). As late as 1947, a former president of the ICAEW, HG Howitt, told the AIA that “Your SEC regulations are much more detailed than anything to which we have aspired, or have thought necessary” (*The Accountant* 2 November 1946, p.225).

The conclusion that the US suffered from an overly interventionist government carried weight in contemporary debates. US accounting was admired for its detail and organisation, but there was a strongly-held view that the price of government intervention was too high. What is also striking is that the US was not considered as a model for the UK when company law reform began to be debated again. The Cohen Committee's minutes in 1943-4 are full of proposals for the future direction of company law, taken from across the political spectrum and throughout industry, law and financial services -but references to the USA are few and brief. The staff of the *Economist* who gave evidence put forward a case for a British SEC; but it should not be a "slavish imitation" of the original - it was probably not necessary for it to regulate the Stock Exchange (Cohen p.544). This is not simply because of British chauvinism. The Committee took extensive evidence about German company law from two émigré German lawyers (Cohen pp. 630-651); there were discussions of practice in South Africa (Cohen p104, p.231) and the Netherlands (Cohen p.166). The British view of the US seems to be permeated by a sense that the US environment was profoundly different - and in particular unduly bureaucratic - in a way that made it inappropriate as a model for reform.

9 US views of the UK

This section deals with three features of the UK regime which were regarded in the US as distinctive – the existence of company law dealing with financial reporting, the requirement to produce consolidated accounts and the reporting of income. US commentators on the UK were particularly aware that the UK profession had a longer history. As will be seen below, this was thought to have a negative side – the UK "lagged behind"; but it also had some advantages. One was the enjoyment of public recognition. The *Journal of Accountancy* in 1930 made a lengthy rejoinder to a comment by Dicksee about the US profession that "in the States nothing is done without advertisement". The *Journal* asserted that "The accounting profession in this country does not receive one-half the publicity which it receives and deserves to receive, in Great Britain. There, the profession is older, its position is more assured, and it is not necessary to inform the public what an accountant is and does. Every business man, every banker, every judge upon the bench knows of what stuff accountancy is made". (vol. 49, p.165). By contrast, the US profession needed to promote itself more actively.

Company Law

Companies legislation was also seen by US commentators as conferring advantages. Previts and Merino comment that "AIA members spent (…) an inordinate amount of time debating terminology"(1998, p.291), and statutory guidelines about such issues as the auditor's responsibilities and rights would have reduced the scope for debate. This is presumably what May had in mind when he commented that "In England (…) the situation is now fairly clearly defined by statute" (*Journal of Accountancy* 1926 vol. 42, p.322). In attacking the shortcomings of US financial reporting, Ripley suggested that the US had "something (...) to learn" from the British Companies Acts. (*The Accountant* 5 March 1927 p.352). Ripley was thinking of "independent auditing...under the supervision of shareholders" (op.cit. p 351). His view was too idealised - he claimed that in the UK "an independent executive committee of the shareholders" would determine accounting issues (ibid.) - but he saw the UK as better regulated than the US. There was clear support for his view as far as audit was concerned. As early as 1926 an editorial in the *Journal of Accountancy* recommended that an audit "certificate" ought to "follow somewhat the requirements of the English and Canadian companies acts" (1926 vol. 42, p.285).

Senator Norbeck introduced the Federal Securities Bill to Senate as "copied after the British law". He reminded Senate that the US was "the only great industrial and commercial nation on earth which lacks a national code of law dealing with the creation and business conduct of corporations" (*Congressional Record* 1933 p3223). The AIA subsequently endorsed UK practice in its auditing recommendations by advocating an audit report "as in England" rather than a certificate, and in particular the use of the phrase "in our (my) opinion" (*The Accountant* 19 May 1934 p.707). The *Journal of Accountancy* characterised the UK system as one of "shareholders' audits", with two main merits:

"(F)irst that it places some real responsibility on the auditors, so that self-protection requires them either to take a stand against directors when they regard the directors' proposals as unjustifiable or else to resign: and secondly, that it requires ample notice of any proposed change of auditors and thus makes it difficult for directors to supersede auditors who disagree with them" (1926 vol. 42, p.283)

Consolidated accounts

But the view taken by the US profession was generally that the UK "lagged behind the development of modern methods in business", whereas in US the profession "had the advantages of growing with the growth of business procedure". (*Journal Of Accountancy,* January 1932, p.6). Underlying this was a view that UK financial reporting did not provide the information that users needed. GO May was the senior executive partner of Price Waterhouse in the US between the wars, and had the opportunity to compare UK and US practice. He concluded that "the firm and the profession in Britain were miles behind the times and miles behind the Americans" (Jones 1995 p182). In a letter to *The Accountant* (2 June 1934 p.775) May expressed serious reservations about the quality of UK reporting - "the meagre accounts published by some of the largest UK companies". He criticised the "opinion given by distinguished counsel to the effect that it is not a necessary part of the purpose of a statutory balance sheet to show the value of *any* asset, the purpose being only to show what has become of the funds of the company". May advocated the preparation of consolidated accounts, as being essential to obtaining "any correct idea of the real state of its affairs, unless the words 'its affairs' are construed in a very narrow legalistic manner". He was not alone in regarding UK accounting as legalistic. W A Staub CPA, speaking at the International Congress of Accounting in New York in 1929, explained that the consolidated balance sheet represented "an effort to look through form to substance" (*The Accountant* 7. December 1929 p.731). He was implicitly contrasting it with the UK preoccupation with the legal reality of assets under the ownership of different companies.

Income reporting

Writing in 1938 May contrasted the survival of the "laissez-faire" attitude in UK with the US, where "obviously (its) day has passed" (*The Accountant*, May 21 p.701). He attacked the UK emphasis on the balance sheet, "used by the secretive company director as the red herring to distract public attention from the income account" (loc.cit. p.702). The priority May gave to the income account is an important difference between the UK and the US. When the AIA report on "Audits of Corporate Accounts" was given as evidence to the US Committee on Banking and Currency on 1 January 1933. (*The Accountant* 19 May 1934) it included a clear statement about the function of accounts. They were designed to enable investors to decide whether to buy or sell shares, and

"not to bring about a change of policy or failing that a change of management... The only practical way in which an investor can today give expression to his conclusions in regard to the management of a corporation in which he is interested is by retaining, increasing or disposing of his investment, and accounts are mainly valuable to him in so far as they afford guidance in determining which of these courses he shall pursue" (loc.cit., p.700).

For this reason, the income account was "usually far more important than the balance sheet" because "the earning capacity is the fact of crucial importance in the valuation of an industrial enterprise" (p.699). The UK's downplaying of the income account was clear evidence for the AIA that it "lagged behind".

The AIA's comment deserves attention because it highlights a fundamental difference between the UK and the US – the importance placed on the usefulness of accounts to the investor. Underlying the US position was the assertion that the function of accounts was to inform and empower the investor by providing a basis for decision-making about trading shares. From this standpoint, information about income was essential, and secret reserves were highly undesirable. This contrasts with the conservative UK view that investors should not be given too much insight into what companies were doing to earn dividends. The managing director of J. Lyons Ltd, for instance, firmly told his shareholders in 1932 that "I hope nobody will ask me (...) for more detailed information than has been given, because (...) if I had thought it expedient to publish it the information would have been given in detail in our accounts" (*Economist* 18 June 1932, p.1376). The contrast with the 34-page accounts of Bethlehem Steel described above could not be more marked.

Information about income was recognised as being sensitive on both sides of the Atlantic. The difference was that in the US this was seen as an argument for disclosure in order to let shareholders react as they saw fit: in the UK there was still a strong paternalist view that shareholders would react inappropriately and non-disclosure was in their interest because it prevented panic.

10 Cross-national perspectives

The preceding sections have outlined the areas where the two regimes had acknowledged differences. This invites questions of why these differences arose and why there was not more pressure for a convergence of practice between the two regimes. This section of the paper attempts to identify the distinctive features of the economic, political and professional contexts in which accounting was carried out.

The UK – the determining factors

The characteristics of the UK environment that were arguably most important in determining the nature of regulation, and which are reviewed here, were the stance of the accounting profession, the nature of the investing public, and the attitude of legislators to the need for accounting change.

Two characteristics of the accounting profession are particularly worthy of attention; its readiness to defend its position, and its attitude towards investors. The ICAEW President A E Cutforth, quoted above, opposed accounting legislation in the 1930s on the grounds that "any legislation which has the effect of limiting our discretionary powers may be calculated to undermine our status". The ICAEW's line was that its professionalism would be impaired if the government interfered in the details of accountants' and auditors' work. The quality of financial reporting depended ultimately on the exercise of judgement rather than the application of rules created by legislators. As noted above, the ICAEW persisted with this attitude throughout the 1930s, and UK commentators expressed something like pity for the US profession, faced as it was with "control" by government.

The other distinctive feature of the stance taken by the UK profession was its attitude towards investors. The anonymous writer quoted above who stigmatised the "merely temporary shareholder, or gambler in the company's shares" was not alone. The UK profession insisted that shareholders should have confidence in their board, support their decisions and be prepared to wait for a satisfactory dividend. If they wanted information or explanations, they should go to the directors to get them. There is a marked contrast between this and the conclusion of May's Committee (quoted above) that "the only practical way in which an investor can today give expression to his conclusions (...) is by retaining, increasing or disposing of his investment". In Hirschman's terms the ICAEW's corporate governance philosophy was one of loyalty and the exercise of "voice" by shareholders. The profession in the US assumed that that era had passed, and that the role of accounts was to provide information as a basis for "exit" behaviour. The ICAEW's attitude to secret reserves is quite in keeping with their view that long-term investors did not need detailed published information. and short-termists did not deserve it.

There was also a perception in the UK that equity investment was far more significant in the US than it was at home. Withers, for instance, in his survey of investment trends, stressed that in comparison with the UK, the US was a "huge market" for equity capital (Withers p.185). Florence, writing somewhat later, reiterated the point that the British attitude to investment was that of the *rentier*: "Those who wish to risk money do so in Britain in horse-racing, the dog tracks and football pools, not in industrial investments", whereas the American attitude was that of "the gambler, looking to a profit margin from quick resale of shares" (Florence p.285). Florence quoted in support of his verdict the comment by Keynes in 1935 that "It is rare (...) for an American to invest, as many Englishmen still do, 'for income'; and he will not readily purchase an investment except in the hope of capital appreciation" (Florence p285). If detailed profit information was constructed as the province of a minority, short-termist group, – ie irrelevant to the needs of "genuine" investors who would wait for capital appreciation - it was easier to dismiss calls for more explicit accounting data.

The attitude of UK politicians to the need for accounting regulation was in general lukewarm. There was some political pressure for wider disclosure – e.g. Bevin's call quoted above for disclosure of reserves and the comments of the Liberal Industrial Inquiry but this was weakened by a number of factors. On the Left, the Labour Party showed little interest in accounting issues; its main strategy for economic reform was public ownership rather than an improvement of the information given to private investors. There was Liberal support for more information, but this was outweighed by a number of other factors. The scale of financial causes celebres in the UK – e.g.

the 1929 RMSP case and the collapse of Clarence Hatry's companies in the same year (Manley, 1976)- was nothing like as catastrophic as that experienced in the US. Although there was a growing interest in investment in the UK, a far smaller proportion of the population was involved in share ownership –and hence affected by crashes – than had been the case in the US. Hence there seemed to be less political advantage to be derived from intervening in the operation of the market. Furthermore, the accounting profession continued to make the case that the exercise of professional ethics and expertise could ward off disaster; government intervention was not needed.

Political and economic factors also militated against wider disclosure because of anxieties about union militancy. Modernisers suggested that better accounting disclosure would promote "industrial peace" and were invaluable to promoting cooperation between labour and management. (See for instance *The Accountant* 7 November 1925, p.735). But the counter to this was that disclosure gave unions too much insight and would facilitate pay claims. The evidence submitted to the Greene Committee persuaded it that to reveal profit information would be playing into the hands of the "labour agitator". (Wilfred Greene quoted in *The Accountant* 13 November 1926, p.681) The perception, neatly expressed by Arnold (1997, p164) was that "The state, during a period of economic and social upheaval, did not believe that it was worth informing the capital markets if it also meant informing the unions". When change did occur, in the 1947 Companies Act, it was with the support of the ICAEW, which called for "the maximum practicable disclosure" in its evidence to the Cohen Committee (Cohen Committee Report, p.388). The ICAEW seems in turn to have been swayed by the Stock Exchange, which began to require consolidated accounts from listed UK companies in 1939 – the profession was keen to maintain its leadership over accounting regulation, and its more proactive approach after 1939 seems to have been an attempt to prevent other bodies from seizing the initiative[4].

The US - the determining factors

Addressing Senate in 1933, Senator Norbeck recited a long list of frauds and scandals investigated by the Senate Committee on Banking and Currency. His conclusion was that "a great deal of the lack of confidence from which this country has suffered so much the last few years" resulted from the "stock-market collapse" and that this in turn was due to "the fact that we have forgotten that money must be earned instead of made" (*Congressional Record* 1933 p3232). This was above all the reason for the urgency of the US legislature in pursuing a new regulatory framework; it created what Merino and Neimark (p.47) describe as a "crisis of credibility" so that there was a need for "restoring confidence in the existing system" (ibid., p.49). Their contention is that the securities legislation "was designed to maintain the ideological, social and economic status quo"; instead of challenging the market, the legislators were trying to rescue it. Macintosh comes to a similar conclusion; securities law was intended "to satisfy the public interest political platform of the day…The issue of safeguarding of shareholder interests… (was) purely coincidental" (Macintosh, p.148)

If the securities legislation is viewed as an initiative to shore up, rather than overturn the status quo, the main difference between the US and the UK appears to be not that one regime underwent massive change and the other did not, but that the market status quo was defended in different ways. More particularly, the accounting profession in the UK was able to represent itself as the champion of the system, and hence was able

[4] See Maltby (2000) for a fuller discussion of the background to the 1947 Companies Act

to make an important contribution to the debate about legislation. The UK profession had made extensive representations to the Greene Committee, and these had been extremely influential. Wilfred Greene stated in a lecture that he could not "take any great responsibility" for the recommendations made with regard to accounts and audit: "They are the results of the joint wisdom of the accountants who were members of the Committee, and they met with the approval of the other members because they were the result of that joint wisdom". (*The Accountant* 13 November 1926, p.684). It is worth noting that the Greene Committee had 3 accountants among its 12 members; the r more interventionist 1947 Companies Act was the work of the Cohen Committee, which included only one accountant among 13 members.

The UK accounting profession in the 1920s and 1930s had a secure position in the UK establishment. Accountants held peerages and government positions; in the Great War, they had taken important jobs in the Civil Service. They were willing and able to express a view about the desirability of accounting legislation in a way that the less organised and prestigious US profession was not. In the USA, Macintosh notes, "the input of the accounting profession into the drafting of the Securities Act was negligible"; the AIA "had no policy or strategy for dealing with the issue (and) no constructive proposals for inclusion in the legislation" (Macintosh 1999, p.148). The internal squabbles described above had weakened the accounting profession in the USA and lowered its public reputation – a problem tacitly recognised by the comment in the *Journal of Accountancy* quoted earlier that the status of the British profession was "more assured" than that in the US.

UK and US accounting disclosure diverged in the interwar period because the UK profession took a more militant attitude towards the defence of its prerogatives. Lower levels of mandatory disclosure were not entirely satisfactory to UK investors, or indeed to all members of the profession. But the accounting establishment reiterated the argument that professional interests were best served by giving the profession its head, and dismissed US accounting regulation as bureaucratic interference. More extensive disclosure requirements were only possible after the upheaval of wartime, and a new ethos of public interest disclosure which it was difficult for the accounting profession to withstand.

11 Conclusion and Implications

The divergence between the statutory framework for accounting in the UK and the US is informative about the different forces at play in the two regimes. This paper has argued that in both, the dominant motive for government intervention or non-intervention was to maintain the status quo – ie the market system. The failure of the US profession to operate as a united body, in the face of the scandals culminating in the 1929 crash, meant that it lost the chance to determine the nature and extent of accounting regulation. The ICAEW was more organised and persuasive – hence the power of its presentation to the Greene Committee – but also sufficiently flexible to change its mind and support more extensive disclosure when it seemed that this was what the Stock Exchange required. UK and US accountants were evidently aware of each others' circumstances, as the discussion in professional journals indicates, but neither side wished to emulate the other. Accountants in the US envied the prestige of the UK profession, and the certainty conferred by the Companies Acts provisions on accounting and audit, but they regarded themselves as more progressive, less hidebound, than their UK counterparts. UK accountants paid attention to technical developments in the US- in particular consolidated reporting – but they regarded the US model of bureaucracy as a threat to professional status. The considerable similarities between the two variants of "Anglo-Saxon capitalism" counted for less than the differences which the professional bodies wished to emphasise and maintain.

In 2002, the ICAEW reacted to the Enron collapse in the US by stressing that such a disaster was unlikely to occur in the UK. The submission by the ICAEW to the Treasury Committee emphasised the difference between US and UK accounting standards – quoted at the beginning of this paper. The US, it claimed, was inclined to favour "the letter of the law rather than the spirit" (ICAEW 2002, p.1) It returned to the same theme later in the submission, in dealing with the safeguards on UK auditor independence: "There is a strong ethos among the United Kingdom accountancy profession of compliance with our demanding principles-based ethical code" (ICAEW 2002, p.16). The similarity with the case made by the ICAEW in the 1930s is striking – the superiority of a system of regulation based on professional ethics over a system of rules, and the key role to be played by the Institute. It remains to be seen whether the Institute is successful in differentiating UK accounting from that practised in the US and hence warding off stringent regulatory intervention.

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