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Accounting for Success

A History of Price Waterhouse in America 1890-1990

David Grayson Allen

Kathleen Mcdermott

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PREFACE

I

This book was originally conceived to help celebrate, in 1990, the one hundredth anniversary of Price Waterhouse (PW) in America. In 1987, during Joseph E. Connor's tenure as senior partner, the firm commissioned The Winthrop Group, Inc., to write its history. Because of the comprehensive research, the lengthy writing process, and the publication timetable, the process concluded during Shaun F. O'Malley's term five years later.

When the project began, this study was seen as a companion and sequel to Chester W. DeMond's *Price, Waterhouse & Co. in America* (1951). A partner in the firm, DeMond had produced a charming but internally focused history. As our research proceeded, it became clear that certain themes and issues central to PW's development since World War II had originated earlier. Accordingly, PW and the authors abandoned the plan to produce a book that would be, in effect, a companion volume to DeMond and decided to cover the entire history of the firm. In keeping with PW's original intent, and recognizing the value of the DeMond work, we lay greater stress on modern times, especially the period since World War II.

In writing this history, the authors have had full access to retired and current PW partners. Since this is the story of a partnership, the viewpoints, opinions, and recollections of these individuals are given a central place in the text. We have also examined the minutes of the firm's leadership committees and the partners' files kept in the Office of the

Firm Secretary. Other material has been gathered from a variety of sources, including the National Information Center, the New York practice office Records Center, National Human Resources, the National Administrative Center in Tampa, Florida, the archives of the British firm, and the retired partners themselves.

During the project, we met periodically with an advisory committee consisting of current and retired PW partners and a noted expert in business history. We are grateful for the advice, comments, and suggestions from this group, which included Albert H. Cohen, Burnell H. DeVos, Jr., Richard D. Fitzgerald, Roger G. Marcellin, committee chair Robert G. Nichols, and Harvard Business School professor Richard H.K. Vietor.

A note about authorship: when this project was conceived, David Grayson Allen acted as project director and co-author on early chapter drafts. Co-author Kathleen McDermott then assumed responsibility for expanding and completing the manuscript and subsequently revised the entire text. Davis Dyer served as general editor for the manuscript.

II

This scholarly history of a major accounting firm is unique to the American accounting profession, and benefits PW, which is unique among the big firms. PW's long history as the pre-eminent firm has given it unrivaled opportunities and challenges. One important task of this history, then, has been to describe the firm's special place in the profession and in the business world, and to identify the business opportunities and problems attendant on being the profession's leader.

PW's long tenure at the pinnacle of the profession has intrigued many commentators. Beginning in 1930, and continuing today, observers have pointed to the air of mystery that surrounds the firm. Unlike the "blue chip" public companies that it audits, PW has long held its financial and operating information close to the vest. We hoped that a careful business history of this firm, while perhaps dispelling some myths, might also yield important insights about the challenges faced by a decentralized partnership and about the competitive and operational pressures it has experienced over the past four decades.

This book is about the growth of a professional institution, a partnership that has endured and flourished for one hundred years. It is a success story, describing how a small entity grew to dominate its profession and today is generally considered the most prestigious of the large firms. This is also a book about management and policy formation within a leading firm, identifying the changing processes through which

practice strategies and organizational structures were developed. Finally, this is a history of the growth of an industry, viewed through the window that PW provides.

The world in which the partnership originated was very different from that of the 1990s, and there was nothing inevitable about PW's rise to leadership in the profession. In 1890, the British firm of PW established an agency in New York. Its sole function in its first year was to investigate the accounts of American breweries for British investors. At the time, Britain was the world's foremost economic power, and its investment in the United States was at an all-time high. All the agency's work came through referrals from the British firm. A single transplanted Englishman ran the American outpost, with temporary help supplied by the parent firm. The new entity operated in an undeveloped, unregulated environment, for although England had legislation starting in the 1840s defining the role of accountants, no corresponding laws existed in the United States. All American accounting firms at the time were small, and professional standards or generally accepted accounting principles as we know them today did not exist. Communication both nationally and internationally was relatively slow, and the fastest mode of transatlantic travel was by steamship.

Both PW and the profession have changed enormously since the firm's early days. The American partnership now numbers more than 900, in more than 100 offices, with 12,000 staff members. This firm, which is now the largest in the global PW organization, leads all other PW firms in developing referral work for multinationals outside its territory and has clients throughout American industry. At present, no dominant international economic power exists, and there are many countries that have adopted a global focus and competitive strategy. In the 1990s, capital is again flowing to Europe and to the Pacific Rim countries. The accounting profession, too, has been transformed into a global industry. The multinational accounting firm is a major business force that seems likely to grow still larger, perhaps through mergers, in the years ahead. Big Six practice is regulated and entrenched, making it difficult for newer or smaller firms to enter the market or to compete. In addition, the big firms' global focus, necessary to serve multinational corporations properly, and their reliance on instantaneous communication and computer technology place them squarely in the forefront of change in the 1990s.

PW's first century divides readily into three fairly distinct periods. The first embraces the years from 1890 to the late 1920s and the establishment and Americanization of the practice. The second, from the early 1930s to the early 1970s, encompasses the firm's period of dominance in a regulated environment as auditors to America's largest and

most powerful corporations. The third era carries us to the present time, a period of global challenges and quickening competition.

During the first phase, many of PW's enduring and distinctive characteristics were established. The gradual Americanization of the firm, its decentralized structure, dispersed offices, autonomous partners, leading reputation, and generalist orientation were all in place by the early 1930s. The securities laws enacted in 1933 and 1934 mandated periodic financial reports of listed companies and marked the start of PW's long period of unrivaled professional leadership. The audit, which became the centerpiece of the firm's practice, assumed a new importance as the basis for the financial statements that led to greater investor confidence. George O. May's key role in the regulatory process and his extraordinary force of personality and intellect gave the firm an unmatched visibility, as well as an enduring reputation for integrity and probity. Also during these years, PW's roster of *Fortune* 500 audit clients for many years more than twice that of its nearest competitor brought a luster to the firm.

With the onset of the oil crisis and the beginning of American adjustment to the international economy in the early 1970s, PW along with the rest of American business embarked on a troubled and tumultuous period. Global challenge, heightened competition among the large firms, the growth of nonaudit services, a long series of congressional investigations, and a dramatic rise in litigation directed at accountants were among the most important changes characterizing the modern period.

Cutting across PW's century are six principal themes. The first is the central role of the partner. A study of a manufacturing company might highlight key products or markets. Price Waterhouse, in contrast, must give center stage to its people, for it is a partnership engaged in providing a professional service. The firm has been highly selective in its partnership admissions process and, as a result, its partners have always believed that they are "in a class by themselves." More than one partner told us of his first partnership meeting, when he surveyed with awe the tremendous talent assembled in one room. Out of this collective self-image grew a mutual respect and collegiality. Clearly, throughout its history, the firm has benefited from the frank and generous spirit growing out of these institutional values.

Though some aspects of the partnership endure, others appear to be yielding to modern imperatives. For example, PW traditionally governed itself under an unusually decentralized organizational structure and gave its few and far-flung partners a wide latitude. Today, the partnership is still relatively small compared to other accounting firms, and the "professionally autonomous partner" remains close to the core of the

firm's strategic thinking. Since the early 1980s, however, a growing emphasis on specialization has begun to dislodge the traditional "generalist" orientation of firm partners. Similarly, a distrust, even disdain, for marketing has been transformed into a partnershipwide belief in the importance of identifying new service areas and developing new clients. Finally, a move away from the firm's geographical organizational structure toward another centered around services is a clear departure from most of PW's history.

A second theme running through this history is the significant role that the law has played in shaping the profession's rights and responsibilities. Government regulation, for example, furnished enormous opportunities for the profession in the audit and tax fields. Yet the law has also, more recently, provided a serious constraint in the form of liability suits brought against accountants. These suits underscore the inherent tensions of the professional role, for in their audit work accountants must serve both their clients and the public interest.

A third theme, the changing nature of accountants' services, can be traced in a circular fashion. The Securities Exchange Act of 1934 required listed companies to issue periodic financial statements, making accounting and auditing work the firm's *raison d'être* for the next forty years. During PW's early decades, the firm provided a wide array of services, just as it does today. In this respect, PW is returning to an emphasis on the consulting work that was at the core of its practice a century ago.

Fourth, the business environment for accountants is continually evolving, so that aspects of practice in the 1990s strikingly resemble those of a century ago. Now, as then, it is a volatile, highly competitive world, with much of the work risky and episodic. In 1890, the agency competed against other British accountants, and American accountants as well, to provide a little-known service. Similarly, in the 1990s, the firm must contend not only with the other firms in the Big Six, but also with information technology companies, large management consulting firms, and financial institutions to provide innovative products in new markets. By contrast, the interlude of 1934 to the 1970s saw a more ordered, less threatening practice environment that allowed many firms, and particularly PW, to grow powerful and influential.

The fifth theme identifies the public face of the firm's leadership. In a profession not generally known for its visibility, PW's leaders have consistently shown a high profile, and the firm's role as a leader in new approaches to accounting research and practice has greatly enhanced its prestige. From the first decades of the twentieth century to the present, the firm has attracted and developed individuals capable of assuming public roles, either as leaders of the profession, as public servants, or as spokespeople for the critical issues of their time.

A final theme is the firm's worldwide approach to its business. Although the U.S. firm grew to be the largest of the PW partnerships, it has always respected its relationships to the other PW firms around the world. Like the DeMond book, which ends the U.S. firm's first fifty years with the establishment of the Price Waterhouse & Co. (International Firm), this history closes with the American partnership's recognition that, more than ever, its interest lies with the worldwide PW organization and in a global strategy.

The structure of this book reflects the nature of the commission to the authors to present a narrative history of a single firm over a one-hundred-year period. This form has its clear virtues, including the opportunity to tell the full story of a significant institution and unlimited access to documents and records generally inaccessible to serious historians. The form also has its limitations, among them the obligation to be comprehensive, which limits the possibilities of exploring themes that might interest academic or other specialist readers. For example, this is not a history of practice, primarily, or of the ideas and techniques of the accounting profession. Rather, technical accounting matters are discussed to illustrate their impacts on PW's growth and on its policies. Similarly, the book does not make detailed comparisons between PW and its competitors. We did not have access to the inner workings of other large firms; as a result, our ability to collect data and draw conclusions on market share, client base, and strategy has been limited by the information available in the public record. A final constraint has been PW's obligation of confidentiality regarding specific client matters.

III

This book consists of eight chapters. The first two describe the partnership's origins in the United States as a one-person agency of the British firm, its subsequent establishment, and its eventual success in its own right. The next three recount the story of the firm's accession, after the securities legislation of the early 1930s, to the pinnacle of the profession and its dominance in a regulated environment through the 1960s. The final three chapters cover the period of global competition and disequilibrium from the early 1970s to 1990.

Although one theme of this history is the decentralized nature of the firm and the autonomy of its partners, we have chosen to organize the book in a "dynastic" manner. This reflects our view that there was a difference between the way the firm's policy and public role were established and the way individual partners and specific practice offices conducted their business. Incoming senior partners often fashioned pol-

icies and directions different from those of their predecessors, and partners often recall the various periods by the particular leaders, many of whom left their distinctive stamp on an era. Over time, however, a PW senior partner's highly personalized pattern of direction gradually gave way, as the changing service requirements of clients, the perfecting of automated information technologies, and the growing internationalization of business compelled the firm to experiment with more formalized and hierarchical organizational structures to ensure effective planning and control.

We also sought to place the firm's development within a larger context. PW's history is inextricably linked to that of a significant body of its clients—American big business in general—and to the environments in which they have operated. The unfolding dynamic of American business history over the last century provides a solid context for understanding today's challenges.

Chapter 1 establishes the origins of the British firm and the first ten years of its American agency. It describes the emergence of the accounting profession in Britain during the unfolding of the Industrial Revolution, as well as the birth of the British firm of PW in 1865. As British capitalists began to invest heavily in the United States in the 1870s and 1880s, they increasingly engaged their accounting firms to make periodic visits there. In 1890, PW established an American agency to handle these investigations. During its first decade, the two PW agents, Lewis Jones and William Caesar, struggled to establish their business on a secure basis. Chapter 1 closes with the death of Jones and the early retirement of Caesar, but with the establishment of a separate American partnership, whose practice was already the largest of its kind in the United States.

Chapter 2 relates the important role played by Arthur Lowes Dickinson from 1901 to 1911. Although an Englishman, Dickinson quickly grasped the importance of playing by American rules, even to the extent of relying on public advertising, much to the consternation of the British partners. During this period, the U.S. firm began to develop its extraordinary range of clients, encompassing the J.P. Morgan interests such as U.S. Steel, the large trusts, and significant government agencies. Until his retirement in 1911, Dickinson sought to secure an ever-greater measure of independence from London. George O. May succeeded Dickinson. As an administrator, he followed the directions set by his predecessor by opening new offices, hiring more local accountants, Americanizing practices and methods, and overseeing the rise of what is now called consulting work. Chapter 2 closes with the growing contemporary sense of PW as a native American accounting firm.

With Chapter 3 we begin our study of the second phase of PW's history. May's successor, William Campbell, led the firm through the

Crash of 1929 and the onset of the Great Depression until his untimely death in 1934. Of all the developments of this tumultuous period, the securities laws of the early 1930s played the most critical role in PW's destiny, for they initiated four decades of regulated equilibrium in the profession and pushed the audit to the center of the firm's practice. During this period, May's work as chairman of the firm and as a leading spokesman for the profession enabled PW to achieve and consolidate its pre-eminent reputation. John Scobie's subsequent senior partnership was almost immediately engulfed by the Securities and Exchange Commission's (SEC) investigation into the McKesson & Robbins matter in 1939, the first important case under the agency's authority. The affair also had an important effect on internal work patterns, for as a result, PW (and the profession as a whole) changed the way it staffed and managed audits and considerably reduced the nonprofessional temporary staff who had performed much of its work in the past. The peculiar circumstances of World War II made the few remaining, and aging, partners ever more independent and led to the hiring of college-educated women as auditors. Scobie's efforts to manage the crises of this period may have contributed to the decline in his health; he died in office in 1944.

Chapter 4, which covers the terms of senior partners Percival Brundage and John Inglis, depicts a golden age. Brundage and Inglis shared similar outlooks and goals, a convergence that made for fifteen years of stable leadership. Both also held important public and professional posts. Brundage served as president of the American Institute of Accountants and, after retirement, as President Dwight Eisenhower's budget director. Inglis contributed to the American Institute of Accountants in a number of distinguished capacities and became president of the National Association of Accountants. His noted insistence on a personal touch with partners and staff underscored their importance in a decentralized, democratic organization. The changing business environment and flow of capital to postwar Europe in this period led PW to establish the International Firm, and opportunities within the profession at home spurred it to a series of mergers with other, smaller firms. The chapter examines the growth and change in the firm's practice, particularly the creation of a small "systems" department to meet client needs for assistance with electronic data processing. The profession's relationship to the law can be clearly seen in the context of the tax practice, where important new legislation in the postwar period brought both increased demands for accounting expertise and sharp conflict with the bar.

Chapter 5 covers the 1960s and the senior partnership of Herman Bevis against a backdrop of the United States as the world's richest and most powerful nation. Price Waterhouse participated fully in the pros-

perity of this decade, although by its end, signs indicated that the professional environment had grown less tranquil. Corporate trends of growth, merger, and foreign expansion, the burgeoning computer industry, and competition from other large accounting firms figured prominently in the PW business environment. In meeting these challenges, the firm's SEC and international departments were enlarged, and its Tax Department expanded to handle the steady flow of congressional and Internal Revenue Service (IRS) enactments, while the new Management Advisory Services (MAS) Department struggled to secure sufficient computer staff to meet its assignments. On balance, PW competed reactively, pursuing the same course that had ensured its past success.

Within the profession, Bevis took a central, highly visible role in the debate over accounting principles, but he could not prevent either the lack of agreement that followed this debate or the demise of the Accounting Principles Board, the profession's standard-setting body. More positively, his decision to litigate for practice rights in Florida opened the way for all large firms to practice nationally, underscoring both the importance of the legal environment to the profession and PW's traditional leadership role. Within the firm, Bevis's management philosophy, particularly his emphasis on planned growth, led to much discussion about PW's unique nature, and his efforts to strengthen the partnership and develop its infrastructure left a strong mark on the era.

Chapter 6 sounds a different note as it opens the discussion of the third phase of PW's history. The 1970s were marked by contraction, disorientation, and intensified public scrutiny. The bear stock market of the late 1960s and early 1970s heightened criticism of the profession and led to an activist SEC, a full-scale congressional investigation, and the real threat of new government regulation. In addition, the legal environment, which in the past had been a source of opportunity for accountants, became a significant obstacle, as a wave of litigation concerning the financial statements of troubled companies swept the large firms. Within the profession, competition escalated, and re-proposals were occasionally required by clients of long standing. Under the hand of John Biegler, PW met these challenges head on, and through his forceful representation, re-emphasized its claim to leadership of the Big Eight. Within the partnership, Biegler made important democratic reforms and established a distinct, centralized, practice-support National Office. Amid the tumultuous changes in the business and professional environment, PW initiated a federal government consulting practice and a public relations function and introduced a new emphasis on marketing and industry specialization.

Chapter 7 covers the decade of the 1980s and the administration of Joseph Connor. Globalization of the economy, the spread of information

technology, and the restructuring of American industry emerged as the most significant forces driving the business environment of the 1980s. To address these forces, PW acted aggressively to develop and sustain a firmwide strategy for the future, emphasizing specialization. As in the 1950s, the firm contemplated mergers as a competitive strategy, although its plan to unite with Deloitte, Haskins & Sells did not succeed. Following the flow of capital, PW made an important commitment to strengthening its international practice. The ever-growing complexity of tax work, and more important, the rise of consulting services driven by the information technology needs of clients, assumed a more central place in the firm's plans for its future. In his efforts to provide more value-added services from the audit base, for example, Connor, like many PW leaders before him, emerged as a significant public figure.

Chapter 8 briefly reports on key events and themes in the period since 1988, when Shaun O'Malley became senior partner, and identifies aspects of PW's plans for the future. The Appendix provides a list of partners.

As the decade of the 1990s proceeds, American business is girding itself for the intensified competitive challenge to come. Part of that process is a frank appraisal of historical strengths and weaknesses, such as is contained in this history. It is our hope that out of such an inquiry will spring an understanding and an ability to grasp future opportunities. Like the oft-mentioned concept of the PW partner, nothing about PW's current position has developed in historical isolation. Present partners and staff will perhaps find a context for and an understanding of the firm's inherited strengths and its challenges for the future. Similarly, retired partners and former staff who find the firm's present organization or direction not readily understandable may learn that in fact there is a logic to the changes and a relationship to the firm's earlier days. Finally, the general public will learn how PW's rise to prominence fits into the larger trends of American business and economic history.

PART I
ESTABLISHMENT AND AMERICANIZATION

Chapter 1

British Parentage, 1850-1901

Following the American Civil War, the United States quickly emerged as a rapidly growing industrial power. Throughout the 1870s, and especially the 1880s, British capitalists invested heavily in the robust American economy. To oversee their financial interests, British investors increasingly engaged their accounting firms to make periodic visits to the United States.

It was in this buoyant economic context that the British accounting firm of Price, Waterhouse & Co. (PW) decided to open an American agency. Although at first the transatlantic outpost was closely monitored from London, distance and the impact of American conditions on the practice immediately exerted powerful influences on the new agency. During the tumultuous 1890s, the greater part of the office's British client base offered only nonrenewable work, but the wave of mergers in the United States allowed the agency to develop a new practice and, in so doing, to forge an enduring relationship with American big business. Fairly early on, the British firm recognized its United States agency as a distinct operation. The early history of PW in America is primarily the story of the changes in the relationship between the British parent and the American offspring.

Development of the Accounting Profession

Although accounting practice dates from antiquity, the formation of an accounting profession was closely tied to the rise of a modern industrial

society in Britain during the late eighteenth century. The need for accounting services emerged slowly, but by the early decades of the nineteenth century a flurry of textbooks and handbooks on accounting had appeared, reflecting the impact of the Industrial Revolution. Several larger English cities also began to note a few "accountants" among the listings of their inhabitants.

Accountancy was still an indeterminate calling in Britain as late as the 1830s. Men then engaged in accounting not only made simple accounts, but also found it financially necessary to act as auctioneers, appraisers, agents, and debt collectors. Those who called themselves accountants were held in no special esteem and possessed no monopoly in their services. Each of their skills provided occasional employment to many men engaged in other businesses. A method of distinguishing accountants had to come from an external source.

Perhaps more than any other profession in Britain, accounting was shaped by legislation. Throughout the nineteenth century, acts of Parliament came to describe more precisely the work and responsibilities of accountants in the fields of bankruptcy, auctions, and making accounts, the tasks that provided a major focus for British accountants throughout most of the century. At the same time, legislation also changed and regulated the organization and conduct of business and in so doing helped to create the need for corporate accounting. Although industrialization was well under way by the mid-nineteenth century, legal restraints inhibited the size of enterprises and retarded their growth. The passage by Parliament of several "Companies Acts" released entrepreneurial energies by encouraging the creation of corporations with limited liability, which provided a new sphere of activity for accountants. While permitting many private companies to become publicly subscribed, the Companies Acts insisted on the creation of financial safeguards for a widening group of stockholders and the public at large. As a consequence, financial investigations and accounting and auditing for corporations, stockholders, and investors became increasingly more important areas of practice for leading British accountants after the mid-1860s.

Securing legal recognition of a sphere of professional activity for accountants was a slow, evolving process. The Bankruptcy Act of 1831 empowered the appointment of "Official Assignees," and for the first time accountants were specifically mentioned as qualified to hold such positions, although the work could also be taken on by "merchants and brokers." For the most part, however, accountants were mentioned in legislation only by inference and not by name. In the 1842 Act for the Relief of Insolvent Debtors, for instance, a party whose debts were less than £300 could present to the bankruptcy court a petition with a "full

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