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Fair value vs conservatism? Aspects of the history of accounting, auditing, business and finance from ancient Mesopotamia to modern China[☆]

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ABSTRACT

To help understand modern financial accounting theory (FAT) and its role in the development of finance and business, I consider two current mainstream histories of its development and offer a third alternative. The standard setters' version is that increasingly FAT is rationally derived from a basically coherent conceptual framework, currently focussed on 'comprehensive income' as measured by 'changes in assets and liabilities', in turn preferably measured at fair values. However, examination here of several recent FASB/IASB standards and exposure drafts shows that instead they unavoidably bear the marks of the history of a variety of now embedded practices that have shaped thinking about, and vested interests in, what is 'good accounting'. By contrast, some recent academic versions of history focus on how 'conservative', historical-cost based accounting principles have rationally evolved to provide an anchor on which to base appraisal of firms' and managers' performance, prospects and risks, and supply the kind of information that investors and other parties in the capital markets need to help overcome the information asymmetry between them and corporate managers. After analysing the limitations of this second type of history, I argue that even a brief genealogical examination of the conditions of possibility that have led to the growth and changes in accounting and auditing practices and discourses, and in the power-knowledge relations that they have engendered at different stages over the millennia of recorded history, suggests that their power has always been more that of 'institutional rationalised myth'. The twin rational myths of the objectivity of accounting and of auditing together provide the structure that offers the comfort necessary to enable the various agents in the modern, increasingly global, economy to undertake and finance the risks of acting 'at a distance' and across time. This modern, grammatocentric accountability increasingly extends throughout the institutions that coordinate modern societies, in the rising East as well as in the established West. Exploring how much of FAT is rational and reflects some objective 'economic reality' and how much is myth and is subjectively, socially constructed; and, again, how much might be improved and how much is intractable, are the major questions now for accounting, auditing and finance policy-making and research. This requires further detailed comparative international historical understanding of how accounting and auditing have variously operated, within businesses and other organisations and in shaping markets, across different countries and cultures.

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[☆] Due to publication constraints the editors have abridged the footnotes in the author's submitted version. The full paper can be found at <http://www.lse.ac.uk/accounting/facultyAndStaff/profiles/macve.aspx> or by contacting the author at: R.Macve@lse.ac.uk

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‘...distinguish clearly each item... assigning the usual value to each. *Set the price higher (fatter) rather than lower (leaner), so that if you believe it is worth 20, attribute 24 etc. so that you can more easily obtain a profit*’. (Luca Pacioli, 1494, Ch.12: instructions for the journal entries for opening assets (emphasis added)) (von Gebattel, 1994, p.54).

‘The definition [of Prudence] basically says that if you are in doubt about the value of an asset or a liability it is better to exercise *caution*. This is plain common sense which we all should try to apply in our daily life.’ (Hans Hoogevorst, Chairman IASB, 2012, *The Concept of Prudence: dead or alive?* (emphasis added))¹

1. Introduction²

1.1. Fair value (FV) vs conservatism

Pacioli’s easy-going instruction on valuing inventory (favouring target pricing over historical cost (HC), or even over current value, for its desirable behavioural consequences—Macve, 1996; 2010a) indicates that valuation issues in accounting were not always regarded as matters of central principle. However, today they are central to the debates on modern accounting standards where the promotion of FV by standard setters has met increasing academic as well as practitioner resistance (e.g. Kothari, Ramanna, & Skinner, 2010; Penman, 2007; cf. Power, 2010). Do the arguments over ‘financial accounting theory’ (FAT) simply go ‘round and round’ or is there some discernible progress (or indeed regress) with each iteration? (cf. Macve, 2013).

I aim to illustrate here how we cannot understand modern FAT (or ‘the conceptual framework of financial accounting principles’ (‘CF’)) in isolation from the history of its social, institutional and market contexts; and also how, in spite of their lack of an agreed conceptual basis, the development of FAT and its twin—auditing—have shaped and will continue to shape important developments in business, financial, accounting and auditing history (BFAAH). Some of my arguments may be familiar (cf. Carnegie & Napier, 2012; Jones & Oldroyd, 2009) and others speculative, but I attempt here to make a tighter connection between the broader historical context and individual modern accounting events and issues. However, this is still work in progress so there will be many unanswered questions for further research.

1.2. Setting the scene

How does one explore the historical linkages between BFAAH and FAT? And what light does the development of each shed on the other? In this paper I can only skim the surface of a history that stretches back millennia and across many arenas, although what we nowadays call FAT (or coherent ‘financial accounting principles’, or the CF) may be regarded as a relatively recent phenomenon. It only took off with the development of joint-stock companies, the increasing separation of ownership and control, and the emergence of ‘big business’, of the accounting and auditing profession, and from then on of the increasingly international stock markets—which have led to the movements first for domestic and now for international financial accounting standardization (Macve, 1983b; Yamey, 1977; Baxter and Davidson, 1977; Zeff, 2009; 2013) alongside the growth of multinational audit firms (cf. Deng & Macve, 2013). Will the fascinating historical and geographical diversity of accounting practices soon disappear into a standardized, uniform, international rule-book and remain of interest only to antiquarian curiosity-hunters? Does accounting face a Fukuyama-type ‘end of history’? I will argue it does not.

In Macve (2002) I briefly addressed how *ancient* accounting history illuminates four of the ‘big’ historical questions: (1) *the relationship between accounting and ‘economic rationality’/business decision making*; (2) *the significance of accounting as writing*; (3) *the significance of ‘double-entry bookkeeping’* and (4) *the relationship between accounting and the State*. I do not want to repeat that analysis here so instead will focus on some important historical work that has emerged in the last few years and just pick out a few illustrative examples from today’s topical issues.³

1.3. ‘Old laudanum in new bottles?’

The ‘official’ history of the evolution of the current state of financial accounting principles—the creed of the FASB and IASB—is that financial accounting and reporting is continually improving, largely through the efforts of the standard setters. Through developing their ‘accounting principles’ and more recently their CF, they claim to have gradually articulated an increasingly coherent set of concepts (i.e. FAT), that guides practice towards ever more consistent recognition and

¹ Speech to FEE Conference on Corporate Reporting of the Future, Brussels, Belgium, Tuesday 18 September 2012: <http://www.ifrs.org/Alerts/PressRelease/Documents/2012/Concept%20of%20Prudence%20speech.pdf> (accessed 7/11/2012).

² It was both a great honour and a great surprise to receive the 2010 Distinguished Academic Award from the British Accounting Association (BAA), now the British Accounting and Finance Association (BAFA). This paper is based on my plenary addresses at the 2011 BAFA annual conference at Aston University (Old laudanum in new bottles?), the 2011 5th MBS/LSE/LUMS Conference at LSE and the 2012 World Conference of Accounting Historians at Newcastle University, together with related presentations at workshops held in 2011, 2012 and 2013 at Saïd Business School, University of Oxford; at SMBA, Aberystwyth University; and at Zhongnan University of Economics and Law (ZUEL), Wuhan, PRC. I am grateful for all the comments received on those occasions as well as from the editors of this special edition of BAR, Mike Jones and David Oldroyd, and from Liu Tianran of Xiamen University, PRC.

³ References here to recent developments are generally based on knowledge publicly available at 14 December 2012.

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