The British Accounting Review 48 (2016) 87–101

Contents lists available at ScienceDirect

The British Accounting Review

journal homepage: www.elsevier.com/locate/bar

Asset valuation, profit measurement and path dependence in Britain to 1800

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ARTICLE INFO

Article history:
Received 1 August 2013
Received in revised form 3 April 2014
Accepted 15 October 2014
Available online 6 December 2014

Keywords:
Accounting history
Asset valuation
Charge and discharge
Double entry bookkeeping
Path dependence

ABSTRACT

The principal historical focus of this paper is the measurement procedures recommended for the use of merchants by accounting thinkers of the early modern period (1550–1800) and employed by them when constructing numerical illustrations intended to approximate the real world of commerce. A clear preference is shown for measurements based on historical cost both overall and when re-examined by author occupation and date of publication. The paper locates these findings within the broader development of accounting from the high Middle Ages through to 1800 to the extent that this is a feasible proposition given limitations of space and the current lack of knowledge about how accounting was actually done. The study draws on the notion of path dependence to help explain the demonstrated hegemony of historical cost through the ages.

1. Introduction

It is frequently asserted that accounting is as old as writing, but most discussion of accounting in Britain begins with the manorial and monastic estates of the thirteenth century (Oldroyd & Dobie, 2009). The charge and discharge-based system of accounting was devised around that time to enable the agent (e.g. the steward) to report to the principal (e.g. the lord of the manor). This is the origin of the term stewardship accounting which signifies, during this early period, a narrow version of accountability, namely to provide a check on the ability of the steward to render a complete and honest account of the resources entrusted to him. Unsurprisingly, the lord of the manor expected the steward to manage the estate efficiently as well as honestly, and there are numerous treatises on estate management testifying to this priority (Oldroyd & Dobie, 2009). Furthermore, there is evidence to show that a strictly cash-based system of charge and discharge accounting might be modified to achieve some of the attributes of accruals accounting, but such elaborations usually relate to later time periods (e.g. Baxter, 1980; Boyns & Edwards, 2013, chapter 4; Jones, 1991; King, 2010).

More extensive claims have been made for the utility of record keeping as a consequence of the development of double entry bookkeeping (DEB). Yamey (1956, p. 7) identified the potential of DEB for providing a more comprehensive and orderly record of business transactions, for helping to confirm the accuracy and completeness of the ledger, and to facilitate the

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http://dx.doi.org/10.1016/j.bar.2014.10.009
0890-8389/

production of a periodic income statement and statement of financial position.[1] Edwards, Dean, and Clarke (2009) have further shown that writers of treatises published in the early modern period (1550–1880) demonstrate the ability of DEB to generate relevant information to assess financial performance and position, and for decision making.

1.1. Scope, limitations, sources and structure

One might imagine that the concern with decision usefulness during the early modern period would have resulted in a shift from cost to value as the recommended measurement basis for financial reports. Certainly this has happened in recent years as the focus on stewardship as the principal objective of financial reports published by joint-stock companies has been replaced by one of decision usefulness.[2] A regulatory manifestation of this transition, in Britain, is that the *Statement of principles for financial reporting* (Accounting Standards Board, 1999, para. 6.6) recognises the following bases for valuing assets and liabilities as possible alternatives to cost: 'entry value (replacement cost), exit value (net realisable value) or value in use (discounted present value of the cash flows expected from continuing use and ultimate sale by the present owner)'.

The purpose of this paper is to improve our understanding of the history of asset valuation and profit measurement procedures by studying how accounting thinkers considered assets should be measured and reported during a period, 1550–1800, when the preparation of the income statement and the balance sheet was in its infancy.[3] The accounting practices of merchants are the focus of this study and Mair (1736, p. 4) explains why their affairs dominated the literature[4]:

> Though this Method of Debitor and Creditor be of a very general Nature, and may be used to good Purpose in most kinds of Accompts; yet I propose to explain it here chiefly with a View to Merchant-Accompts; which as they are the most considerable in themselves, and therefore justly challenge our first Care, so they afford the greatest Variety of different Cases and Circumstances.

This literature-based study also contributes to our understanding of accounting practice during the early modern period. It is not claimed that accounting theory, as exemplified by the early literature, can be equated with contemporary accounting practice. Nevertheless, the measurement procedures explained in the literature might be considered tolerable indicators of actual practice for two reasons. First, some writers and teachers claimed that they described existing business practice. Second, their students would have taken the accounting methods they had learnt with them into the work place.

The findings from the study of DEB treatises are located within the broader development of measurement systems used in financial reports, based on formal systems of record-keeping,[5] from the high Middle Ages through to 1800 to the extent that this is a feasible proposition given limitations of space and the current lack of knowledge about how accounting was actually done. In so doing, this study draws on the notion of path dependence to help explain the demonstrated hegemony of historical cost throughout this long time period.

Research has been facilitated by the ready availability of early treatises in electronic form at Early English Books Online, Eighteenth Century Collections Online and Google Books.[6] At the time of writing, electronic versions of 103 of the 126 bookkeeping texts identified in Edwards (2011) were available for study.[7] Forty-one were excluded for a variety of different reasons,[8] leaving 62 texts the subject of evaluation (Appendix 1). For the six authors with dual publications, the measurement procedures detailed and analysed in this paper were arrived at by combining relevant information from both treatises.

The remainder of the paper is structured as follows. First, path dependence is introduced as a relevant theoretical lens for the purpose of explaining the history of asset valuation and profit measurement procedures up to 1800. Second, the main features of the periodic accounting reports which writers believed should be made available to merchants during the early modern period are described. The asset measurement procedures employed in early bookkeeping texts are next presented to elucidate the degree of support provided for identified alternatives and to discover whether the favoured methods can be

[1] The terms commonly used to describe these statements in books published during the early modern period were profit and loss account and 'balance' or 'ballance', with the latter two terms sometimes linked with the words accompt or account. Other differences in terminology between today and the early modern period include the word 'stock' which was used to signify the balance on the capital account. Also, some terms which it is convenient to use here for ease of communication had no accounting significance during the period covered by this paper. For example, Parker (1994, p. 79) points out that the term 'asset' did not achieve accounting significance until the nineteenth century.

[2] In his extensive study of the changing objectives of corporate reports Zeff (2013, p. 264) notes that, for much of the twentieth century, the purpose of stewardship reporting was to enable shareholders to assess 'management's honesty in husbanding the enterprise resources'. During the twentieth century, in his estimation, the meaning was transformed into one of providing evidence of 'management's efficiency in utilising' shareholders' money and even, perhaps, towards providing a means for shareholders to assess whether management had earned a 'suitable return' on their investment.

[3] Edwards et al. (2009), Yamey (1984) and Yamey et al., (1963) address the question of how early writers tackled measurement issues. None of these writings comprise a systematic study of the relevant literature. Nor do they reach the same conclusions that are presented here.

[4] Occasionally texts on DEB focused on farming, where the activities undertaken gave rise to additional measurement issues, i.e. the creation of assets (crops and newborn livestock) and the transfer of assets between operating units (Edwards, in press).

[5] Measurements of profits and capital prepared on an ad hoc basis, perhaps as the result of the proprietor carrying out an inventory of assets and liabilities, are outside the scope of this paper.

[6] Available at: http://eebo.chadwyck.com/home; http://galenet.galegroup.com/servlet/ECCO?locID=ucw_itc; http://books.google.com/.

[7] In four cases later editions have been identified electronically for use in this paper: Clare, 1758, Dafforne, 1651, London, 1758 and Wise, 1757.

[8] Fifteen because measurement issues were not addressed; eight were reworkings (under a new title) of previously published texts; 10 focused on farming operations, four on retailing, one each on domestic affairs and shipping, and one further text contains insufficient information to enable judgements to be made about the measurement procedures employed. No copy of Oldcastle (1543) survives.