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## Social Origins of Modern Accountancy

BY A. C. LITTLETON

Children and scientists should not enjoy exclusively the privilege of asking unanswerable questions. There are other hard questions besides Who lights the stars at night? and What makes an apple fall? For example, an accountant in a burst of curiosity might like to join the others and ask: Who invented bookkeeping? Who designed auditing?

If such a fit of curiosity, having once descended upon our accountant, should further drive him to do some special reading, his research would still fail to produce definite answers, for, as he presently would become aware, no one invented bookkeeping—it just grew. And no legislative committee devised auditing out of whole cloth to be written in the statutes. Auditing, too, just grew.

Such reading stimulates curiosity still more and induces further questions. Bookkeeping did perhaps just grow, but were there no actuating factors, no conditioning circumstances or starting impulses—no soil, sun or moisture? And so our accountant's restless curiosity grows by what it feeds upon and produces in the end the following:

Bookkeeping under the microscope consists of arithmetic digits written down in a certain way. In essence it seems very simple, but in fact it is quite complex. Those digits, however neatly marshalled, are only symbols that need interpretation. They refer to a bewildering array of different things—lands, goods, money, capital, debts, hopes, savings, losses, promises, wages and a legion of other elements. But to recognize this complexity of constituent elements is only the beginning of understanding. If we turn the microscope upon the several elements themselves—those indispensable antecedents without which there could be no bookkeeping—it will perhaps illuminate the origins of double-entry better than to look steadily at the complex whole.

The art of writing is the first of the indispensable antecedents revealed. It is at once accepted as indispensable, since bookkeeping is first of all a record, and we pass on. Arithmetic is next noticed. It is essential because the mechanical aspect of bookkeeping consists of a sequence of simple computations. Thus are

all the elements of bookkeeping scrutinized. Private property is indispensable, since bookkeeping is concerned with recording the facts about property and property rights; money, because bookkeeping is quite unnecessary except as it reduces all transactions in properties or property rights to this common denominator; credit, for there would be little impulse to make any record whatever if all exchanges were completed on the spot; commerce, for the reason that a merely local trade would never have created enough pressure in volume of business to stimulate men to coordinate diverse ideas into a system; capital, since without capital commerce would be trivial and credit would be inconceivable.

These elements are recognized as essential to the formation of bookkeeping; had any of them not existed, double-entry's appearance would have been problematical. If either property or capital were not present, there would be nothing for records to record. Without money, trade would be only barter; without credit, each transaction would be closed at the time; without commerce, the need for financial records would not extend beyond governmental taxes. If either writing or arithmetic were absent, the vehicle of bookkeeping would not exist.

Essential as they are, however, even these elements could not produce double-entry bookkeeping by merely appearing together historically. All of them were present in some form throughout the era of ancient history, but the early civilizations failed to produce double-entry as the term is now understood.

Writing, for example, is as old as civilization itself. Babylonian mortgages impressed in cuneiform characters upon clay tablets and Egyptian tax collections painted in hieroglyphics upon papyrus can still be read after more than four thousand years. But in none of this writing was there any sign of double-entry bookkeeping; for bookkeeping is more than a writing, although always written.

Arithmetic as we understand it—the easy and systematic manipulation of number symbols—did not exist in the ancient world, although the Greeks made great advances in geometry. Numbers could be expressed by the use of letters of the alphabet, it is true, but arithmetical manipulations, even addition and subtraction, were very difficult to perform. The lack of an easy means of computation must have been as strong a deterrent from organized financial record-making at that time as its later appearance was a favorable factor.

Property is a requisite antecedent to bookkeeping, of course. Without the right to possess, enjoy and dispose of articles of property there would be little reason indeed to "keep books." But property rights under the ancient civilizations were not accompanied by all the other conditions necessary to bookkeeping. Property acquired by conquest or obtained from slave labor is likely to be expended in lavish display or in further wars—in any case, unproductively. The highest conceivable need for bookkeeping under these conditions would be satisfied with a sort of "stores accounting" which would merely tell what property was available. The accounting of the Egyptians did not extend beyond this process, and the financial records of the Roman head of a family were little better—hardly more than a record of receipts and disbursements.

Even the addition of the factor money to private property and the art of writing could not produce double-entry bookkeeping. These three factors made possible a written record of private properties which could be expressed in money as a common denominator. But the stimulus to convert a possibility into an actuality was lacking.

Credit there was too, such as was extended by the ancient money-changers. But this offered little incentive for completely systematic record-making. Loans were for the most part based upon pledged valuables as in modern pawn-brokerage. In the ancient world money was not often lent commercially, but rather against necessity—for consumption rather than for production or trade. Indeed, lending could hardly be called a credit transaction until far into the Middle Ages. A loan upon pledged property was to the lender practically a completed transaction. If the borrower never reappeared to redeem his property it was his loss, not the lender's responsibility. There would be little need here for systematic records.

Nor was the commerce prevalent in the ancient world of the kind to give rise to bookkeeping. The Phœnicians were great traders along the coast of the eastern Mediterranean thirty-five hundred years ago, and are said to have given us our alphabet of twenty-six letters; but it is doubtful whether they gave us double-entry. Barter needs no bookkeeping. The antecedent of double-entry which we designate "commerce" is not just a trading exchange; it must be an extensive commerce in order to produce the pressure of a great volume of trade. This sort did not

exist in the era of ancient history. The demand for trade goods was small because populations were relatively small and largely self-sufficing, as they consisted of many slaves, serfs and poor artisans with low purchasing power and only few people of wealth. Furthermore, the supply of trade goods was limited and the means of transportation inadequate. The commerce which was to assist in the formulation of double-entry had to be a profitable commerce, for this is the best means of saving a fund of capital which can be re-employed productively and thus in turn create additional capital.

This lack may have been the principal reason why the ancient world did not produce complete bookkeeping. The idea of productive capital was not yet present. In that era of an agricultural stage of development there was no occasion to consider capital as a factor in production. This stage was to be followed long afterward by an era of handicraft and one of commerce, and still later by an industrial era. These later stages were better suited to the development of bookkeeping, but none of them had been reached at the time when recurrent waves of invading barbarians pushed the remnants of Roman civilization into Constantinople and closed the doors upon ancient history.

There was capital, in the sense of wealth, in the ancient world, but the mere existence of wealth did not predispose other conditions to the formation of double-entry. Wealth in marble palaces and secret hoards does not create conditions favorable to the appearance of a coördinate system of financial records. But other forms of wealth could do so—wealth, in the form of goods and ships, which is active, turning over, ever changing in producing more. Wealth in such forms creates questions and doubts and hopes, and men, in striving to find answers to these, slowly evolve or adapt methods of records to serve their needs. In other words, wealth in the ancient world was not possessed of the energy to become capital in the sense necessary to make it a true antecedent of double-entry.

Ancient wealth was not productive; it was not capital. It originated in tribute and the spoils of war. Wealth needed the pressure of an extensive and profitable commerce to give it real productivity. Such a commerce appeared in the Middle Ages largely as a result of the crusades. Wealth then originated in active trading exchanges. The purpose of the employment of capital and credit changed from consumption and display to use in

gainful enterprises in supplying newly felt wants with goods from distant sources.

This was the fertile soil from which double-entry grew. But there was need for sun as well as soil. The "sun" was proprietorship.

The early records of mediæval commerce were merely "agency bookkeeping"—the records necessary to enable an agent or the active partner of a specific venture to report intelligently upon his activities. These, together with the records needed by bankers' dealings in exchange, brought personal (debt) accounts into extensive use. Perhaps agency bookkeeping so systematized the record keeping as to make use in some cases of impersonal (goods) accounts and a "master's account."

These conditions produced a system of complementary, bilateral accounts in which duality of entry was a feature and equilibrium of totals was a result. But the achievement was not yet complete.

When continuing partnerships replaced single ventures and occasional agreements, the recording problem passed from that associated with an irregular reporting by an agent to that occasioned by a continuing investment of capital variously employed and periodically summarized. The new burdens expanded the account-procedure of agency bookkeeping into proprietorship bookkeeping. Not until bookkeeping was thus called upon to serve the enterprise as a unit were its full possibilities achieved.

Whereas wealth in antiquity was stagnant, wealth employed in mediæval trade became capital actively striving to reproduce itself. This was the first step toward true commercial proprietorship. The "master's account" of agency bookkeeping foreshadowed the "capital account" of the next step, but it was not thus converted until proprietorship had expanded the need for account-keeping.

The nineteenth century development of professional auditing in Great Britain is another good illustration of the way in which antecedent conditions produce subsequent results. It is not sufficient merely to point to the statutory audit as the basis for the growth of professional experts, for the question immediately arises: Why was such a statute proposed and passed by parliament? There are several parts to the answer.

In the early nineteenth century an increasing pressure was apparent in England in favor of freedom of incorporation. The

resistance of the government slowly weakened and an approach was made in the second quarter of the century to permission for incorporation through compliance with a general statute. That constitutes the first point: the pressure of expanding commerce leads to incorporation by statute.

But the statutes prescribed an annual audit. The second point therefore is that England's unpleasant experience with fraudulent stock promotions in the early eighteenth century—the so-called bubble period—leads to certain safeguard clauses in the corporation statutes of the nineteenth century, such as an audit in the interest of the inactive shareholders of the directors' various activities.

Why is the thing prescribed an audit instead of some other protective device? This, then, is a third point: England's experience in feudal days contained a suitable method for effectively supervising delegated responsibilities—the review or audit of the records of the various officers of the feudal baron's household.

The device had been quite effective and could easily be adapted to the nineteenth-century need. The audit which was prescribed for all joint-stock companies was therefore not without precedent.

But an understanding of why there was a statute and why it prescribed an audit does not also produce an understanding of whence came the men who were to grow into professional experts. The men were, first of all, bookkeepers. Bookkeeping knowledge was basic to auditing; the shareholders' acquaintance with his company's affairs had to come from bookkeeping data prepared for him. But mere acquaintance with the methods of double-entry bookkeeping does not suffice to constitute "experts." When the audit committees, consisting at first only of stockholders, began to understand the complexity of the task assigned to them, they soon sought assistance. They were presently permitted by statute to employ "accountants." No doubt in some cases these earlier outside assistants were simply bookkeepers who were not associated with the specific enterprises. But in many cases someone of more experience and judgment would be needed. Such men were found in the ranks of those who had delved into the inner intricacies of accounts in bankruptcies and other business litigation and therefore had a deeper knowledge of ways and means than could have been obtained merely from writing up transactions.

This bankruptcy work in turn arose from the statutes which sought to protect business creditors when their debtors became insolvent. And since insolvency was directly connected with the long series of financial crises which England experienced, it is evident that business crises of the nineteenth century were contributing factors to the development of professional auditing.

It is noteworthy that the British government played an important part throughout this development. Bankruptcy legislation was passed very early in order to protect creditors as much as possible from unfair losses at the hands of unscrupulous debtors, and it was revised from time to time in various attempts to improve the protection given. The publicity sections of the corporation statutes and the audit provision also had a similar purpose, for they were inserted to protect stockholders (as one type of creditor) from "stock-jobbing" promoters and fraudulent practices by company directors. Here are clear examples wherein organized society (government) undertakes to limit individual action in the interest of unorganized society, the latter being here represented by creditors and stockholders.

This illustrates well the fact that the development of accounting has been relative to society's own development. It is unlikely that professional auditing would have appeared when and where it did if England had had a parliament which was unresponsive to the social needs of the time. Professional accounting, in the nineteenth-century sense, could not have appeared in fifteenth-century England, for the earlier age did not have the right kind of problems to call it forth. And it would be quite as unreasonable to expect to see fifteenth-century charge-and-discharge accounting satisfying the accounting needs of the nineteenth century.

Another good illustration of the interrelation of surrounding conditions and the development of accounting is found in the rise of theory. Double-entry bookkeeping, as expounded in a long line of early texts, was singularly devoid of theoretical discussions. The presentation was almost entirely descriptive—a verbal picture of bookkeeping routine. This in later years was supplemented by a multitude of rules of thumb for resolving transactions into debits and credits. But occasionally in the nineteenth century a bookkeeping teacher appeared who perceived the inadequacies of the method of learning by rote and tried to replace rules by reasons. These few men saw more in bookkeeping than a



clerical routine and in transaction analysis more than a process of account personification. Practical business experience gave them a consciousness of the ultimate purpose of bookkeeping, which the mathematicians and writing masters of an earlier day did not have. And some deep instinct for good teaching seems to have led them to seek ways and means of bringing out the clear logic which was inherent in bookkeeping.

The clue to bookkeeping logic lay in proprietorship. When the teacher began to speculate about the nature of proprietor's expense accounts and about the relation of the enterpriser to his enterprise, theory began. Here is the basis for that fundamental distinction between asset and expense which underlies so much of the theory of accounts. Here too the situation reveals the necessity for a classification of accounts, a grouping together of like accounts which can be viewed in contrast with other groups having other major characteristics. This is recognized as the foundation of much of the value which financial statements possess; it is the basis of the technique of marshaling an array of figures into an enlightening display.

While a good deal of credit for the appearance of accounting theory is due to those teachers who were striving to reveal the intellectual side of double-entry, it is not unlikely that the many problems raised by corporations have created more discussion—and hence more theory—than did the teachers of bookkeeping.

The corporation's contribution to accounting theory is three-fold. Because of limited liability there was a legal obligation to retain in the business the amount of the capital contribution. It became important, therefore, to be able to make an accurate calculation of the amount of assets which could safely be distributed. The necessity for such calculations gave added importance to knowledge enabling one properly to distinguish asset and expense.

Because the incorporation of an enterprise resulted in a definite continuity of economic existence (although with changeable membership), there was an economic obligation to maintain the productive power of the enterprise. Here was a further use for sound theory to guide the management in making periodic calculations of the profits. Here, for example, was the practical justification for the theory of treating depreciation as a necessary cost of production instead of a voluntary reservation of profits.

And finally, because corporations were aggregates of capital under delegated management, it was necessary to substitute

“figure knowledge” for personal acquaintance with detail by investors. Financial statements became the medium of stockholders’ knowledge of their affairs and thus gave added importance to well chosen account classifications which would make the statements clear and understandable.

These various conditions had conspired to improve the logic by means of which business facts were analyzed for bookkeeping records and to increase the clearness with which financial facts were presented to the understanding. This was theory—a refinement of bookkeeping definitions and concepts. Some of these conditions, with others which were more deeply social in nature, created a need for expert professional services and at the same time produced a body of men capable of performing these services. This was auditing—a method of scrutinizing bookkeeping data. Still other circumstances brought about a very great advance in the technique of bookkeeping itself—this was cost accounting.

Our familiarity with the machine age makes it somewhat difficult to realize the revolution which is hidden in cost accounting. Just as double-entry bookkeeping was a revolution in account keeping, so costing, which is a complex process of calculating for one’s self the cost-make-up of his product, was a revolution in commercial bookkeeping wherein an article’s cost was simply the purchase price complete.

When double-entry was developing, and for many generations afterward, business was commercial rather than industrial; it was trade, not manufacture. Production was handicraft work in the family; it was a way of making a living rather than production for later distribution at a profit over cost. There were “costs,” of course—raw materials gathered or grown and the labor of the family—but there were no wages, few employees and little invested capital. There was no need here for cost bookkeeping.

Costing problems began to appear when men began to work for money wages and when enterprising masters brought workmen and material together under one roof. This was the “factory system”; its cost bookkeeping, where any was attempted, was mainly in regard to kinds of material and quantities of articles produced. But, there was a real need to ascertain money costs (material prices, wages paid) in order to “test” the adequacy of selling prices. This was satisfactorily done in a general way quite easily, for “wool” and “wages” could still be treated with the account simplicity of trading expenditures.

The soil in which cost accounting grew was the factory system of production. But it needed the sun of the industrial revolution to help it grow toward its destiny. With the industrial revolution came power machinery—first water wheels, then steam—and with machinery came the costing problems of fixed assets, depreciation, overhead, etc. Later the nature of costing became more clearly evident and its calculations better refined. Methods of allocating cost units to product units were devised with such skill that cost accounting has finally become a veritable symphony of analysis and synthesis. But its origins are the intricate origins of the industrial revolution, the movement away from the land to the towns, the commutation of traditional services into wages, the invention of machines which applied power to productive processes. If we are to understand cost accounting fully, these must constitute the background. Costing therefore, like double-entry book-keeping, auditing and accounting theory, was a product of surrounding conditions.