A history of corporate financial reporting in Britain, by John Richard Edwards, New York and Abingdon, Oxon, Routledge, 2019, xxv + 380pp., illus., £84.84 (hardback), ISBN: 9781138553187; £36.44 (e-book), ISBN: 9781315148441

This excellent book by a renowned expert on the history of accounting in the British Isles focuses on 'corporate financial reporting', i.e. the development of accounting by corporate, profit-seeking, entities to (mainly) their external owners/shareholders, and reliably conveys what modern historical research (including Edwards's own) has revealed. It begins with the East-India Company's formation in 1600 (including an illustration of its 1782 balance sheet) and then traces the developments over the next four centuries, with an endpoint in 2005. It is framed from an 'agency theory' perspective where shareholders are the 'principals', company directors/executives are the 'agents', and the accounts are a means to facilitate the monitoring by the former of the performance of the latter. But the agents have mixed incentives: the need to overcome the information asymmetry between themselves and external principals and give those principals confidence in investing their capital prompts commitment to full and fair accounting disclosure, but the moral hazard of being able to take advantage of their inside information to exploit their principals encourages agents to withhold information, and manipulate accounts by devices such as 'secret reserve' accounting to smooth out results, which became regarded in the 1920s as a wise, paternalistic precaution against giving investors and the stock market shocks that might cause panic. In Edwards's view the history shows the latter temptation repeatedly overcoming the former motive, thereby leading to continual attempts at regulatory tightening.

From 1844 companies could be incorporated simply by registration, with limited liability for shareholders available from 1855. The accounting profession was formally established in the second half of the century and compulsory professional annual audit was required of all limited companies from 1907 (later gradually relaxed to exempt smaller companies). During the later 19th century and the 20th and 21st century leaders of the profession (who included company chairmen as they do today) experimented with changes, debated accounting issues and led the development of common standards both nationally and increasingly internationally until more independent bodies, national and then international such as IASB, were established to reflect the wider interests involved (and in particular those arising from the expansion of stock markets), alongside ever increasing governmental (including EU) regulatory involvement.

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There are nineteen chapters. Part 1 (two chapters) outlines the basic chronological pattern of developments; Part 2 (two chapters) looks at the 17th and 18th centuries and introduces the problems (and subjectivity) involved in profit measurement and asset valuation, focussing on fixed assets, inventories and debtors and presenting the 'path dependence' inherent both in shaping developments and in explaining the stickiness of conventions once established (such as historical cost accounting ('HCA')), by analogy with the survival of the technically inefficient QWERTY keyboard.

Part 3 (two chapters) gives an explanation of the development of 19th century regulation from initial *laissez faire* and illustrates the 'Double Account System' adopted by the railways to handle the accounting problems arising from the unprecedented scale of their investment in physical infrastructure and in its subsequent maintenance and repair, before the system of regular depreciation accounting that is now familiar became established.

Part 4 (two chapters) traces developments in company law, focussing on dividend distribution and capital maintenance rules (increasingly relaxed by the Courts until reimposed by an EC Directive from 1980) and then on the incrementalist approach to reform adopted by successive Committees until a major shift after WWII resulted in the 1948 Companies Act, including a prohibition on secret reserve accounting (except in the case of banking, insurance and shipping companies). Meanwhile in 1942 in order to help improve practice the ICAEW had launched its series of *Recommendations on Accounting Principles* which were the forerunners of the accounting standards that have been issued from 1971 onwards.

Part 5 (one chapter) reviews some of the notorious financial accounting scandals that produced major pressures for reform of accounting, audit and disclosure, covering the Railway Mania of the 1840s, the City of Glasgow Bank failure in 1878, and the Royal Mail Case in 1931 (see also Toms, S. 'Financial scandals: a historical overview', *Accounting and Business Research* (2019) 49(5): 477-499).

Part 6 (8 chapters) reviews a range of financial reporting issues, including the 1970s debates over 'inflation accounting' and the recommendation of the government-appointed Sandilands Committee that companies should adopt Current Cost Accounting (basically valuing assets

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and charging their use at replacement cost instead of historical cost). Here the significant contributions to the debate from academics, in particular from LSE and Lancaster University, is emphasised.

Part 7 (one chapter) reviews the development of accounting standards and the related search by the standard setters for a comprehensive 'Conceptual Framework', that had begun in the US in the 1970s. Again the contributions to theory in the UK made by LSE academics (beginning in the 1930s) is highlighted.

Finally, Part 8 (one chapter) reflects on an overall history of 'continuity with change', where various *causes célèbres* have acted as 'game changers' punctuating the underlying path dependency that has kept accounting practice generally anchored in HCA despite recent intensification of arguments for 'fair value' accounting. It concludes with a reminder that the motives of 'agents' have throughout continued to find new ways to circumvent requirements for fuller transparency to their 'principals'. Much empirical econometric research by accounting academics is nowadays focussed on investigating how extensively and successfully companies deploy 'earnings management' to improve their stockmarket rating (and/or the company's tax bill or legal dividend capacity), including the 'real earnings management' which results from taking harmful investment and operating decisions (e.g. delaying or cancelling research and development investment) to avoid having to take unwanted charges against current reported profits.

The book is extremely well structured, with signposts within chapters and a review section at the end of each one. A helpful 'Timeline' of major events is provided and various supporting tables, appendices and illustrations. Technical accounting terms are clearly explained and should be understandable to those with a knowledge of business and business history. Moreover the presentation makes clear that accounting practices have essentially been the inventions and innovations of business managers themselves, although in recent times they have become more and more constrained by concerns for regulatory compliance which have tended to reinforce the institutionalised path dependence that inhibits bold new experiments.

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Turning to my reservations….While Edwards wisely explains why his title is '*A*' history he does not clarify where he means by 'Britain'—generally an ill-defined term (e.g. https://www.smithsonianmag.com/smart-news/whats-difference-between-england-britain-and-uk-180959558/). The text focuses on the UK but, even after Irish independence and before both countries joined the EU, the UK legal and standard setting framework has been shared with the whole of Ireland. It is noted that, following the UK's accession in 1973, 'subsequent companies acts are driven by European Directives' but apparently they are still 'British'. However Edwards draws the curtain on the book's 'British' history in 2005 because then EU Regulation 1606/2002 took 'effect in Britain to mark the end of "British Accounting" by companies publishing consolidated financial statements', as from then on it required compliance with IASB standards as adopted in the EU (pp. xxiii; xxv). However, given the UK's continuing major influence in the EU (until 2020), the legacy of its shared pre-eminence, alongside the US, over a long period in shaping international accounting practice (including in the Empire and then the Commonwealth), its longstanding and continuing powerful influence in IASB, and the global importance of its multinational (and cross-listed) companies and of its stock exchange, it is inevitably somewhat arbitrary to attempt to focus on it as an individual country/region. Correspondingly the leading audit firms have expanded from their primarily UK and US origins to become today's global professional enterprises. A brief exploration of this broader international context within which that editorial choice was made—and what factors have therefore had to be left out—would have been helpful to a non-expert reader.

In the longest section, Part 6, Edwards's personal selection of particular financial reporting issues for discussion necessarily omits a number of other potential topics. From my own perspective (and in the light of more recent controversies and ongoing debates) it would have been valuable to have included a discussion of the history of accounting for *intangible* assets and for long-term liabilities. There are occasional references to arguments over accounting for goodwill arising on mergers and acquisitions, but not to accounting for investment in research and development or for brands etc. and to the anomaly that acquired intangibles are treated as assets but self-generated ones are not. On the other side of the balance sheet, leasing obligations are covered in a couple of pages in Chapter 15 but there is no discussion of accounting for defined benefit pension plans and environmental liabilities and only passing

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mention of the controversies over 'deferred taxation' liabilities. The most recent balance sheet illustration is from 1969 (pp. 184-5) before these items had reached their present-day scale and materiality and before they became the subject of (still controversial) new IASB standards.

While it is noted in Chapter 2 that the original 1844 Companies Act had been partly prompted by the many scandals surrounding life insurance companies behaving as Ponzi-type schemes (such as *The Independent West Middlesex Fire and Life Assurance Company* whose collapse in 1841 was satirized by Dickens in *Martin Chuzzlewit*), there is no discussion of why the prevailing accounting conventions could not cope adequately with measuring such long-term liabilities until the 1870 Life Assurance Companies Act (omitted from the timeline at p.xx) finally accepted the principles of actuarial discounting. And how those principles can most appropriately be applied in measuring life companies' *performance* has only now been specified in IASB's 2017 standard, IFRS 17 (effective 2023) which, despite 20 years of gestation, itself still remains controversial.

I would also quibble with the description throughout that the prevailing measurement system (argued to have probably been maintained through path dependence despite being focussed on the past rather than on the future that decision makers—whether investors or managers—must evaluate) is 'historical cost accounting' (HCA). In principle and in practice it is actually 'recoverable cost accounting' whereby 'conditional conservatism' is applied to write down both current and fixed assets from cost to their recoverable amount when their economic value is considered to have been impaired, whether as anticipated (e.g. by charging annual depreciation) or unexpectedly (as in provisions for what are discovered to be unsaleable inventory, uncollectable debts, and impaired fixed assets, tangible and intangible). It is asymmetric as assets are not normally 'written up' (except for those entering the consolidated accounts on a takeover and nowadays also in the case of many financial instruments) although the proposal for wider revaluations is at the heart of the debates over 'fair value' accounting as an alternative to 'HCA'. So actual accounting practice is a strange (and highly subjective and still generally opaque) mixture of the past and the future.

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It should also be borne in mind that the focus of the book is primarily on the accounts themselves (balance sheet, profit and loss account or 'income statement', and cash flow statement) plus the audit report. Initially these covered only a few pages but, as shown in the list of the contents of Lloyds Banking Group's 300 page annual report and accounts for 2016 (p.191), while those accounts (with their ever expanding accompanying explanatory notes) have themselves become much more complex they nevertheless constitute only about 100 pages of the total report. Chapter 10 illustrates how companies are now required (following EU Directives) to provide a 'Strategic Report' explaining their business model, key performance indicators and risks etc., and extensive information about their governance structures and risk management. There are also a lot of additional 'voluntary' disclosures which Edwards observes may be 'principally designed to achieve impression management' (p.192). This phenomenon reflects an underlying problem with the basic philosophy, established from the beginning of the history of corporate financial reporting, that the accounts are what the absentee 'principals' need to monitor their 'agents'. The numbers in themselves, while providing some basic reassurance that the invested funds have not been inappropriately squandered or misappropriated (their basic *stewardship* function) cannot, without explanation of the subjective assumptions underlying them and the business context within which they are reported, provide much guidance on how the performance of a company and its management can be gauged and its prospects and risks evaluated. The accounts themselves may be necessary, but they are far from sufficient. And in addition there has been, from the beginning, the burgeoning network of a critical press and of stock-market analysts acting as 'information intermediaries', in explaining corporate success and exposing failure, to complement companies' own financial reporting (e.g. Taylor, J. 'Watchdogs or apologists? Financial journalism and company fraud in early Victorian Britain' *Historical Research*, 85(230) (November 2012): 632-650).

These reservations do not detract from my overall admiration of the book. It is aimed primarily at complementing 'courses on financial accounting, corporate reporting and auditing; also, as a resource for researchers in accounting history'. But it 'should prove useful to business, financial and economic historians' (p.xviii). And indeed Edwards succeeds in showing throughout how accounting issues have always been a major concern of business

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executives and had a key role in shaping the 'principal/agent' relationships that underpin business organizations and thereby our capitalist system and its history.

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