Accounting is an Evolved Economic Institution
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Accounting is an Evolved Economic Institution

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Abstract

We develop our paper by defining “accounting history research” and posing six big picture questions about historical accounting evolution. The paper selectively summarizes accounting history over the past ten thousand years, organized around our six questions. This review provides useful examples that we draw upon for subsequent sections, but can also be used as a US accounting history primer. We explain how accounting history can inform scholars studying modern institutions by analyzing several exemplary research papers. The paper discusses numerous empirical studies using archival accounting data and suggests further questions that can build upon and extend published research. Finally, we discuss the implications of our evolutionary perspective for accounting research, and identify numerous research opportunities.

\textsuperscript{*}This essay is dedicated to the memory of our colleague, George Benston, who passed away earlier this year. George was a consummate scholar who believed strongly in the value of economics-based policy research informed by intelligent data analysis. He also was a person of remarkable energy and zest for life. We shall miss him.
under each of our six big picture questions that will together help us build a coherent evolutionary theory of accounting.

Yet, if it is too pessimistic a view that man learns nothing from history, it may well be questioned whether he always learns the truth. While the events of the past are the source of the experience of the human race, their opinions are determined not by the objective facts but by the records and interpretations to which they have access. Few men will deny that our views about the goodness or badness of different institutions are largely determined by what we believe to have been their effects in the past. There is scarcely a political ideal or concept which does not involve opinions about a whole series of past events, and there are few historical memories which do not serve as a symbol of some political aim. Yet the historical beliefs which guide us in the present are not always in accord with the facts; sometimes they are even the effects rather than the cause of political beliefs. Historical myths have perhaps played nearly as great a role in shaping opinion as historical facts. Yet we can hardly hope to profit from past experience unless the facts from which we draw our conclusions are correct.

— Friedrich Hayek, “History and Politics” (1954, pp. 1–2)

Without a knowledge of history, the accountant may not be sufficiently aware of the evolutionary nature of society.

— American Accounting Association (AAA) Committee on the Future Structure, Content, and Scope of Accounting Education (1986, p. 181)
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Accounting is an economic institution whose recordkeeping origins are at least 10,000 years old (Schmandt-Besserat, 1992). Double-entry bookkeeping emerged spontaneously in 13th century Italian businesses and was summarized in Pacioli’s (1494) classic printed text. After the corporate form was introduced in 16th century Britain (Micklethwait and Wooldridge, 2003), bookkeeping increased in complexity. Accounting, which classifies, aggregates, and summarizes business performance using a firm’s comprehensive transactional history, is only a few hundred years old (Ijiri, 1975). Even within this relatively short time, modern corporate accounting largely took shape with little explicit direction from formal standard-setters.

Accounting, like other economic institutions, has evolved through a path-dependent historical process over thousands of years wherein current practices are influenced by both the recent and distant past. Hence, accounting scholars need to seriously confront history to understand the ultimate reasons why accounting institutions take their modern form. Written conceptual frameworks have guided accounting standards only in recent decades. Yet, accountants almost exclusively use implicit theories of intentional design to analyze accounting practices, whether
Introduction: Why Accounting History Research is Valuable

imbedded in regulators’ conceptual frameworks or academics’ comparative static analyses. As a result, we understand virtually nothing about how the important economic institution of accounting evolves spontaneously with the expansion of economic exchange and division of labor that underlie economic growth (North, 2005; A. Smith, 1776; V. L. Smith, 2003).

Accounting history research commands little market share in our most visible research journals. For example, very few empirical papers published recently in leading US academic accounting journals relied on historical data for their design and execution.\footnote{To illustrate, there were 16 archival papers published in the January 2007 issue of The Accounting Review, the March 2007 issue of the Journal of Accounting Research, and the March 2007 issue of the Journal of Accounting and Economics. Of these, only three studies include any sample data from before 1980 whereas 12 have samples drawn entirely from the post-1990 period. None of the three studies using data from before 1980 are ones where historical data is necessary to execute the study (two are asset pricing studies while one is a methodological analysis of the properties of accounting conservatism measures). Fleischman and Radcliffe (2005) discuss the lack of historical publications in major US journals within the broader context of how accounting history research developed in the 1990’s.}

Despite the fact that accounting is one of the oldest economic institutions, accounting scholars rarely learn much accounting history.\footnote{Human recordkeeping is first evidenced by the tokens of Ancient Mesopotamia that date back to approximately 8,000 BCE, and humans invented writing to keep better accounting records (see Basu and Waymire (2006), pp. 213–217, and references therein).} The consequence is that we leave many important questions about accounting unanswered, and in some cases, even unstated. Yet, if accounting is largely an evolved institution, then accounting history research likely is of first-order importance for a deep scientific understanding of our discipline.

We claim that studying the history of accounting evolution is socially valuable for several reasons. First, accounting institutional history can provide useful background knowledge and context for scholars seeking to understand modern institutions, many of which have deep roots in the past. Historical research provides fodder for thought experiments that let us envision alternative institutional arrangements that could have emerged but did not; in the process, these thought experiments could offer a creative spark for innovative research. In other words, research that is informed by history allows us to better
understand that which we cannot directly observe or measure rather than only “what is” (Bastiat, 1848; Hayek, 1989; Smith, 2003).

Second, historical data provide unique opportunities to study issues of enduring importance. Finance and economics scholars increasingly use historical data to study important questions such as why people contribute to charities or whether common law economies always perform better than code law economies. Historical data often allow us to obtain relatively unconfounded evidence on the economic, political, and social forces at play in major accounting decisions. Examples of this approach include how corporate disclosure policies are chosen in unregulated settings (Benston, 1969, 1973; Sivakumar and Waymire, 1993, 1994), the incentives for the use of early audits (Watts and Zimmerman, 1983), and the evolution of accounting as a centerpiece of investor protection mechanisms that underlie corporate governance (Barton and Waymire, 2004; Bushman and Smith, 2001).

Third, history is the necessary focus of evolutionary theories that seek an ultimate explanation for how human societies and economic institutions are shaped over a long period of time. Knowledge of accounting history allows one to better grasp the deeper function of accounting, which is to enable humans to cooperate far more broadly and intensively than any other species (Wilson, 1975). Accounting promotes economic evaluation that provides the foundation for trust upon which sophisticated economic organizations and markets can develop (Mises, 1949; Schumpeter, 1950; Sombart, 1919; Weber, 1927, 1956). We expect that the transactional memory and improved decision-making facilitated by evolved accounting will ultimately be seen as a key causal mechanism through which Adam Smith’s “Invisible Hand” is manifested in economic organizations, markets, and related economic institutions.

Fourth, a lack of historical knowledge can predispose researchers to confirmation bias. One reason is that researchers can easily recall the recent events that prompted their research hypotheses but may be unaware of prior events that would reveal their hypotheses were false (one form of overfitting data). For instance, education in the “fair value” accounting abuses of the 1920s might chasten some of its advocates today. More importantly, as our opening quote from
Hayek emphasizes, researchers may develop theories relying on “factoids” or myths about accounting history that are very different from what actually transpired. As a result, researchers could incorrectly treat falsifying data as confirmatory. Furthermore, many important accounting research questions have been examined many times over using different research methods, and invoking prior answers can make current answers more persuasive.

Finally, studying accounting history can help develop professional identity, not just for accounting scholars but also for accounting students. Current financial accounting textbooks routinely introduce accounting history with the formation of the SEC in 1934 and its delegation of accounting rule-making to private standard-setting bodies. Accounting students often get the mistaken impression that the accounting profession was created recently by government mandate. If they learned instead that accounting is hypothesized to have enabled the emergence of capitalism, or that accountants invented reading, writing and arithmetic, they would be more likely to be proud of their careers and accomplishments (Hatfield [1924]).

We develop our survey by defining “accounting history research” and posing six big picture questions about historical accounting evolution in Section 2. Section 3 selectively summarizes accounting history over the past ten thousand years, organized around our six questions. This review provides useful examples that we draw upon for subsequent sections, but can also be used as a US accounting history primer. In Section 4, we explain how accounting history can inform scholars studying modern institutions by analyzing several exemplary research papers. Section 5 discusses numerous empirical studies using archival accounting data and suggests further questions that can build upon and extend published research. In Section 6, we discuss the implications of our evolutionary perspective for accounting research, and identify numerous research opportunities under each of our six big picture questions that will together help us build a coherent evolutionary theory of accounting. Concluding remarks are offered in Section 7.


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