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Abstract: The purpose of this paper is to examine how the demand for independent audits and the German accounting profession evolved from the late 1800s to the early 1930s despite the absence of competitive market forces. The paper posits that cultural ideologies, specifically with respect to nationalism, paternalism and anti-individualism, provide reasons for the unique configuration of not only the German corporate/banking structures responsible for originating financial reports but the accounting profession that audited them. As the German accounting profession was in an embryonic stage, it was not capable of successfully confronting the corporate/banking alliance to significantly impact financial reporting or the demand for audits. Economic crises served as the dominant pressure for business reform and legislation mandating audits in Germany.

In 1931, a Presidential Decree and the ensuing Company Law mandated annual audits for large public firms in Germany (*Aktiengesellschaften*, or AGs), and gave government sanction to the German accounting profession.¹ Perhaps due to their importance for the national economic good, the AGs were the only non-service companies subject to mandatory audits. The limited liability companies (*Gesellschaften mit beschränkter Haftung* or *GmbHs*), and the sole proprietor operations escaped the effects of the new Company Law. Tax law, however, regulated the accounting of these latter two entities [Düring, 1939; Beuck, 1939].

Although the German legislature had made numerous attempts to amend the Company Law as early as 1926, stock-

¹The 1931 Company Law not only changed the accounting profession but also further regulated financial reporting by specifying classification formats and valuation techniques for balance sheet and profit and loss accounts. The 1931 Commercial Code also contained regulations related to the general shareholders meeting and to management's responsibility for annual reports [Voss, 1933].

company and bank failures precipitated the emergency Presidential Decree and rapid enactment of the revised Company Law [Grossmann, 1930; Düring, 1939; Abel, 1967]. The draft of the 1931 Company Law cited the recent collapse of various enterprises, including the second largest insurance company FAVAG, to illustrate the need for mandatory audits [Dyckhoorn and Sinning, 1989a]. Semler [1939] argued that the new law was a direct effort on the part of the government to prevent future company failures.

From World War I (WWI) to the 1930s, the German government struggled with critical national economic problems such as reparation payments and *Kapitalnot* [Schmidt, 1934]. *Kapitalnot* refers to the shortage of capital that followed WWI as a result of reparation payments to the victorious Allies, German investment in tangible goods to fight hyperinflation, and the importation of foodstuffs and raw materials. A disconcerted public placed pressure on the legislature for economic reorganization that redefined auditor accountability and provided the framework for the reform of accounting and auditing standards [Düring, 1939; Semler, 1939; Stolper, 1940; Abel, 1967; Dyckhoorn and Sinning, 1989a].

Several explanations exist for the emergence of audits and an accounting profession to provide auditing services. Wallace [1985] and DeAngelo [1981] depict audits as a commodity, subject to the same laws of supply and demand as any other commodity in an unregulated competitive market. They suggest that audits serve as a monitoring device for outside stockholders to deter management stealth and management decisions contrary to owners' interests.² Audits possess value because they provide a means to improve the quality of financial statements for both investors and management, thereby enhancing user confidence in the audited information. Both authors argue against the need for mandatory audits, stating that government regulation may be inefficient since private mechanisms of contracting and pricing may serve to supply society's informational needs.³ If audits

²See Jensen and Meckling [1976] for a discussion on the demand for audits as a monitoring device.

³Authors such as Previt and Merino [1979] offer evidence that private market mechanisms do not provide a sufficient supply of financial information to investors. A corporate philosophy that equates secrecy to success, such as that found in the Ivar Kreuger case [Flesher and Flesher, 1986], suggests that the business sector may withhold information requisite for investor decisions.

possess value in unregulated markets, as Wallace [1985] and DeAngelo [1981] suggest, then such markets also require an accounting profession to provide the audit services.

Germany's financial markets lacked a strong competitive atmosphere and did not exhibit a compelling demand for independent audits during the first three decades of the twentieth century. Harmony among the German corporate, banking and government interests and lack of widespread ownership served to diminish the need for monitoring and external access to information [Abel, 1971; Dykxhoorn and Sinning, 1989a; Gallhofer and Haslam, 1991]. Thus, audit demand does not appear to provide a strong basis for the emergence of the German accounting profession.

Theories drawn from the sociology of professions literature offer arguments other than audit demand for the emergence of an accounting profession. During the 1960s, sociologists began to take a new approach that viewed professions as political groups which can influence economics, markets, the state and class systems [Freidson, 1986]. Some sociologists posit that members of occupational groups employ specialized knowledge, credentialism and closure to establish professions that externally delineate their disciplines from other occupations [Larson, 1977].⁴ If a profession can control the educational requirements and admission to its field, it can optimize its position of power in the market by controlling the supply of labor.

Freidson [1986, p. 35] warns that the term *profession* must be employed as "a historically and nationally specific 'folk concept'." He claims that professions only arise in industrial countries influenced by Anglo-American institutions.⁵ After the arrival of industrialization in England and the U.S., strong market economies, decentralized passive governments and *laissez faire* attitudes enabled successful occupations to achieve monopolistic professional power in competitive, unregulated markets.

⁴Freidson [1986] describes credentials as items that provide information regarding the ability of a worker. Examples are diplomas, professional certification, licenses and personal testimonials. *Closure* refers to the ability of a profession to exclude unwanted outsiders in order to achieve market control [MacDonald, 1985].

⁵Individuals entering the preindustrial professions of law, medicine and religion achieved status through attending respected universities and through elitist stations acquired by birth [Freidson, 1986].

These conditions, Freidson [1986] argues, did not exist in industrialized continental Europe where occupations did not have to campaign for status. The middle class achieved status through education at elite, state sponsored educational institutions [Freidson, 1986]. Graduates often obtained positions in civil service organizations or technical jobs in large cartels. Bureaucratic entities, not market position, offered occupational security and protection. Freidson's analysis suggests that accounting professions only emerge in conjunction with competitive market forces and would not appear under a bureaucratic government and communal ideology such as that found in Germany.

The arguments of Wallace [1985], DeAngelo [1981] and Freidson [1986] pose the question:

Does only one form of economic system, i.e., competitive markets, generate a demand for independent audits and an accounting profession?

Abercrombie *et al.* [1986] provide evidence that may explain how audits and the German accounting profession existed in the absence of competitive market forces. They submit that capitalism can surface under diverse ideologies and suggest that these ideologies affect the way capitalism is implemented. Thus, the form of capitalism found in a given country usually reflects the dominant ideology in that country. Using Japan as an example, Abercrombie *et al.* [1986] illustrate how cooperative capitalism can co-exist with the societal attributes of nationalism, paternalism and anti-individualism that stress collective responsibility rather than individual competitive effort.

Abel [1971] offers an additional explanation for the emergence of the German accounting profession. He argues that throughout the history of Germany, economic collapses, not the evolution of accounting theory, have been the chief motivating factor for Company Law adjustments. Economic crises, not competitive market forces, may have been the motivation in the demand for external audits. This study suggests that the universal concepts of nationalism, paternalism and anti-individualism, found in Abercrombie *et al.* [1986], provide contextual richness for understanding how economic events are reflected in the structural evolution of institutions such as the corporate/banking alliance in Germany, and in turn, the accounting profession. The analysis attempts to understand how political, economic

and social conditions impacted the emergence of the accounting profession in Germany despite the lack of competitive market forces to demand audits.

Awareness of the interaction among political, social and economic forces may assist in the current effort towards harmonization of accounting standards. Dykxhoorn and Sinning [1989b] note that Germany delayed adoption of the European Economic Community (EEC) Fourth Directive for seven years. The intention of the Directive was to harmonize accounting practice within the EEC. One means of European harmonization was the extension of mandatory audits to limited liability companies. The authors state that the Directive, rather than promoting unanimity, fostered discord within the German accounting profession. Sensitivity to the ideological history of the German accounting profession may have provided insight into conflicts over EEC directives and the resistance of the German accounting community to accounting and auditing harmonization.

This paper first defines the analytic narrative methodology [Porter, 1981] that the analysis employs to examine the emergence of the German accounting profession. Next, the paper discusses the ideologies of nationalism, paternalism and anti-individualism and explains how these three concepts influenced German institutions. Included in this discussion is an analysis of the impact of the corporate/banking alliance on accounting practice and the evolution of the accounting profession. The study then traces the evolution of the German accounting profession from the nineteenth century, but focuses on its development during the first three decades of the 1900s.⁶ The analysis ends with the economic crises of the 1930s, the accompanying federal legislation mandating audits and the establishment of the new professional accountant, the *Wirtschaftsprüfer* (WP). *Wirtschaftsprüfer* can be translated literally as economic examiner [Summary, 1939, p. 96]. These accountants are licensed statutorily much as Certified Public Accountants (CPAs) in the United States (U.S.) today. The analysis concludes that despite an environment of cooperative capitalism, a demand for independent audits evolved. Economic crises provided the need for

⁶As most early accountants also performed auditing duties, this study uses the term *practitioner* in a universal sense that includes accountants and auditors without attempting to differentiate between the two roles. The paper does not include an examination of managerial accounting.

business and accounting reform, while Germany's ideological interpretation of the universals of nationalism, paternalism and individualism structured the accounting profession in a culturally unique way.

METHODOLOGY

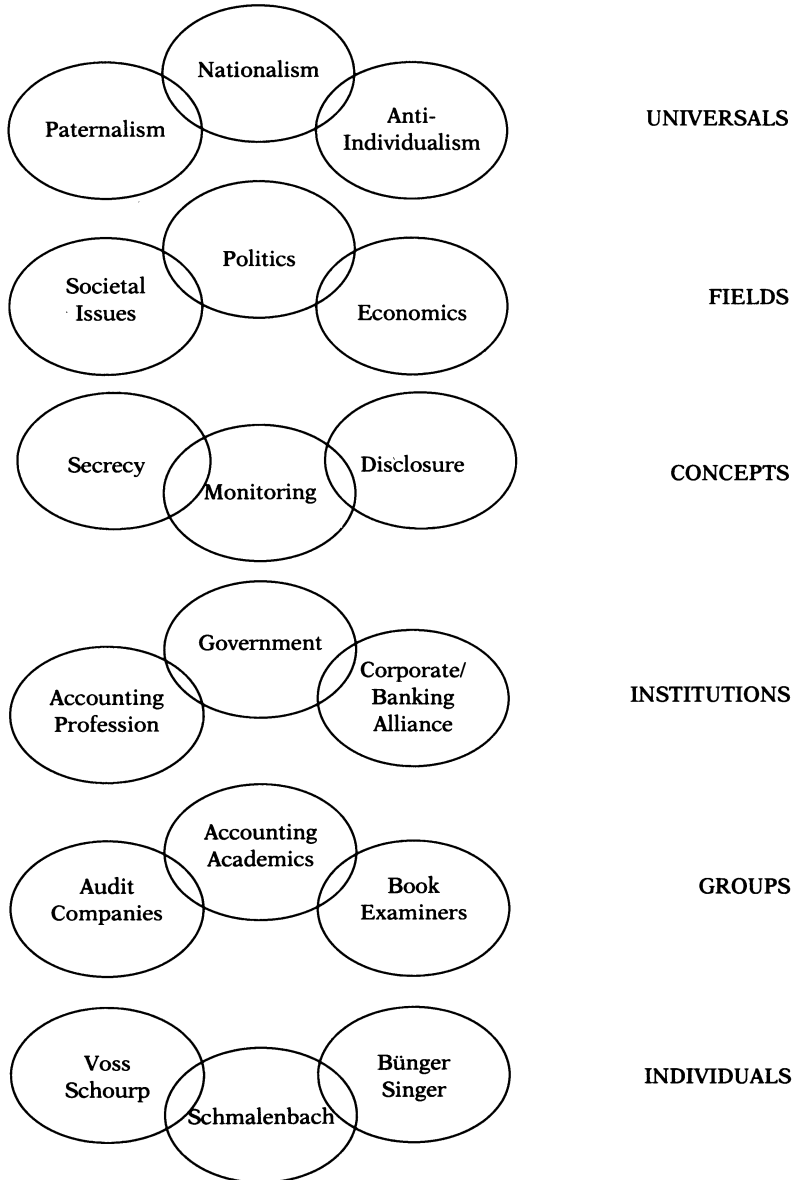
The study employs the literature from Porter's [1981] theory of emergence to trace the evolution of the German accounting profession and its interaction with the socioeconomic factors of the period. Emergence refers to the "process of organization through which each entity becomes temporarily and spatially connected with its antecedent world" [Porter, 1981, p. 74]. Porter [1981] explains that the historical event consists of a unique pattern of emergence where each event singularly interacts with antecedent conditions by culling specific attributes which pertain solely to itself. Porter's [1981] methodology consists of an analytic narrative designed to focus on the chronological pattern of similar occurrences followed by a backward contrasting between subsequent and prior events to analyze their association. The retrospective process highlights discontinuities, or unexpected relationships, that may be marked by the initial sequential analysis.

The first step in an analytic narrative is to identify a phenomenon of interest which in this study is the emergence of legislation mandating audits. Then, in explaining the temporal sequence of an event, the researcher should examine the ascending hierarchical interaction of individuals, groups, institutions, concepts (ideas and principles), fields (disciplines such as economics) and the "most abstract level of thought, universals, involved in a *specific* event's organization [Porter, 1981, p. 86].

This analysis treats the accounting profession as an institution that interacts with other institutions such as the corporate/banking community and the national government (see Figure 1). Three primary accounting groups: academics, book examiners and audit companies, constitute the institution of the German accounting profession during its evolutionary period in the first three decades of the twentieth century. Throughout the study, the analysis considers the interaction of these groups and institutions with concepts, such as secrecy, disclosure, and monitoring, socioeconomic phenomena, and lastly with the cultural attributes of nationalism, paternalism and individualism, which it treats as universals.

FIGURE 1

Porter's [1981] Ascending Hierarchy of Elements Applied to the Emergence of the 1931 Germany Company Law



EVENT: *1931 Germany Company Law* Mandating Audits and Establishing a New Class of Accountant, the *Wirtschaftsprüfer*.

THREE PREVAILING IDEOLOGIES AND THEIR IMPACT ON GERMAN INSTITUTIONS

Abercrombie *et al.* [1986] suggest that three cultural elements: nationalism, paternalism and individualism, influence the form of capitalism, and other societal structures, extant in a nation. The analysis employs Abercrombie *et al.*'s [1986] approach in suggesting that the German accounting profession emerged in an economic and political atmosphere that reflected communitarian concepts rather than an ideology based on individualism.

Nationalism as a Characteristic of Germany

The coexistence of nationalism with capitalism in modern Germany demonstrates the contradiction inherent in the evolution of German political ideology. Free-trade and social democracy co-existed. During the eighteenth century, national Prussian policies promoted the growth of *Cameralism* (Mercantilism) that supported the protection of the markets from foreign intrusion. Cameralism, the predominant economic policy of the period, was synonymous with the creation of a state institution embodying a national economy [Schmoller, 1967]. Liberalism, while used to justify arguments for free trade, always remained shrouded in a tradition of state involvement that shielded market positions.⁷ Industries and trade groups frequently looked to the government for protection.

The evolution from feudalism to industrialism promoted the formation of joint-stock companies during the 1800s. Throughout the first three decades of the twentieth century, large German corporations maintained an interactive relationship with the Reich government. The German government actively promoted consolidation, perceiving cartels as more effi-

⁷Liberalism in Germany referred to a policy of individual freedom, but unlike that found in England or France. German liberalism remained cloaked in "the Cameralist tradition of state intervention" and a sense of community [Hasek, 1925, p. 90]. Industries and trade groups, economically depressed by unregulated competition, looked to the government for protection. The state frequently intervened by nationalizing particular industries, such as the railroad and the utilities, considered essential for the country's good. Direct government supervision, however, did not ensue until the banking crises of 1931 and did not become the norm until the advent of National Socialism [Stolper, 1940].

cient than a free market.⁸ Turner [1985] and Gallhofer and Haslam [1991] suggest that cartels depended on the German government for financial survival; the Reich's purpose in preserving the large corporations was to maintain industrial production and employment.

Gallhofer and Haslam [1991] conclude that the German government condoned conservatism and secrecy over disclosure to promote corporate stability. Banks became so powerful that they were able to compel secrecy while simultaneously earning the trust of the public. The public generally did not have an abiding faith in *laissez faire* economics, therefore, corporate concentration and secrecy did not generate vigorous criticism, until a time of crisis [Semler, 1938; Gallhofer and Haslam, 1991].

The Impact of Paternalism

Paternalism evolved from the Junker feudalistic perception of *noblesse oblige* [Stern, 1975]. Nobility conferred an obligation to behave charitably towards all people. Hegel's notion of the subordination of the individual to the State to promote the communal good may have been an evolutionary consequence of the early feudal tenet of *noblesse oblige*. The government responded to the social problems of industrialization by enacting paternalistic social reforms such as health insurance and work-hour improvements in an effort to repress further labor revolt [Ullmann, 1981; Gallhofer and Haslam, 1991]. Paternalism helped to justify establishment of a modified corporate welfare system in Germany.

Executives of the large corporations also exhibited the characteristic of *noblesse oblige* in attempts at improving worker welfare.⁹ However, Hay [1981] argues that after WWI German industrialists dropped social welfare as a positive tactic to prevent strikes and maintain production when the social programs failed to increase worker efficiency and preserve peace. Despite the limited degree of welfare reform, an ostensible paternalistic attitude enabled bankers and industrialists to avoid recrimina-

⁸Unlike the U.S., the German government did not enact anti-trust legislation to foster competition.

⁹See Tampke [1981] and Stolper [1940] for examples of labor welfare measures such as guaranteed fixed incomes, eight-hour work days and prohibition of Sunday labor for women and children.

tions of greed and self-interest. The State assumed that executives and cartel directorates would exercise effective paternalistic control that would protect the public and promote the national good. Corporate stability would benefit all.

The Impact of Anti-individualism

Abercrombie *et al.* [1986] define three types of individualism: political liberalism, economic or classical liberalism, and individuality or Romanticism. Political liberalism implies equal rights for each person. Economic liberalism, represented by a utilitarian *laissez-faire* perspective, posits that market self-regulation will maximize the well being of a nation. Prussians were not egalitarian and classical liberalism never existed even as a rudimentary ideology [Stern, 1975]. The only form of individualism found in Germany was that of the Romantic which stressed individual genius, not individual rights.¹⁰ German individualism accepted rigid controls through bureaucracy as long as society permitted freedom of thought.

German Romantic individualism, tempered by a strong nationalistic and paternalistic tradition, enjoined everyone to work for the communal good and led to cooperative capitalism. Cooperative capitalism did not provide an environment conducive to individual competition where professional market protection through the achievement of status and credentials were requisite to professional survival.

The Impact of the Corporate/Banking Alliance On Accounting Practice

Two major institutions, stock corporations (AGs) and banks, interacted with the accounting profession in establishing accounting and audit practice. Germany's system of cooperative capitalism sustained a climate of anti-individualism whose laws supported cartels and failed to protect individual shareholders or encourage widespread stock ownership [Gallhofer and Haslam, 1991]. The Prussian Commercial Code of 1884 ostensibly protected minority shareholders by furnishing the right to challenge accounting statements at general assembly meetings [Gallhofer and Haslam, 1991]. However, minority shareholders

¹⁰For examples of thoughts on the freedom of individual genius within the Romantic Movement, see Schlegel [1968] and Schleiermacher [1977].

rarely marshalled sufficient support to meet the Code ownership percentage requirements for protests. Disclosure of financial data to protect the *average investor* did not become a major issue. Abel [1971] concludes that the primary intent of government regulation was to protect the creditors, not the shareholders.

*Kreditbanken*¹¹ were closely linked with the AGs and served in the dual roles of creditors and majority stockholders [Neuburger, 1977]. Their main purpose before WWI was the long-term capitalization of industry. *Sparkassen*, similar to U.S. savings and loan institutions, supplied credit to individuals and small businesses [Northrop, 1938]. Banks owned the majority of corporate stock, served on corporate boards, were involved with stock market speculation and had little concern with the interests of individual minority shareholders [Northrop, 1938; Baker, 1970]. By 1933, only six banks controlled all financial institutions. Banks had a competitive advantage. They collected all necessary financial information via ownership and supervisory board representation and through their own audit companies, the *Treuhandgesellschaften* [Abel, 1971; Gallhofer and Haslam, 1991]. Therefore, they did not favor independent audits and full disclosure.

Interlocking directorates, encouraged by the government to maximize the nation's well being, provided a mutually supportive linkage between corporations and banks. German supervisory boards, composed of management from banks and other stock corporations, were responsible for internal auditing, the presentation of reported earnings at the annual shareholders' meeting, and approval of certain business arrangements [Gallhofer and Haslam, 1991; Dykxhoorn and Sinning, 1989a].¹²

The institutional structure may have precluded supervisory boards from being effective monitors when corporate management was involved with fraud, embezzlement and deceptive balance sheets. Interlocking directories meant managers of one company served on supervisory boards of other companies. If

¹¹Although the main purpose of the *Kreditbanken* was the long-term capitalization of industry, they performed a variety of functions including those of stock broker, underwriter, and supplier of short-term credit [Neuburger, 1977].

¹²See Dykxhoorn and Sinning [1989a] for a more detailed discussion of German corporate directorates. The authors translated H. Gottschalk, *Die Lehren aus den Aktienskandalen der Nachkriegszeit*, (Frankfurt, 1934) for their analysis.

the boards, who selected management, exposed fraud, then their judgement would have been called into question. Thus, directors rarely challenged management directly [Dyckxhoorn and Sinning, 1989a].

Gallhofer and Haslam [1991] explain that corporate and banking institutions actively promoted secret reserves and conservatism for stability.¹³ Corporate management, supported by national protectionism, promoted conservative accounting. Numerous reasons existed for creating secret reserves, i.e., the limitation of profit distributions to minority shareholders, protection of creditors (the *Kreditbanken*), independence from the Reichsbank credit system, and the hiding of WWI profits obtained from government contract work [Gallhofer and Haslam, 1991; Northrop, 1938; Stolper, 1940]. However, Abel [1971] asserts that protection of creditors remained the dominate reason for government permissiveness on secrecy regarding capital accumulation until World War II. Secret reserves solidified and amplified the position and power of one group, the banks (*Kreditbanken*).

Voss [1933] explains that while secret reserves would preclude an auditor from conferring a certificate that the accounts were correct, they would not prevent the examiner from confirming that the accounts agree with the legal requirements. Secret reserves “. . . are in principle allowed by the law” [Voss, 1933, p. 532]. Gallhofer and Haslam [1991] agree that the German government not only condoned, but encouraged secrecy to ensure capital accumulation as well as confidentiality. Forrester [1984] implies that companies still employ secret reserves in financial reporting, compelling analysts to adjust published German profits upward for these surpluses.¹⁴

The complex interrelationships between banks and AGs precluded the use of an audit as an effective monitoring device. The

¹³See Gallhofer and Haslam [1991] for a discussion on how conservative accounting created secret reserves. See Forrester [1977] for a discussion on how early cameralist accounting, a type of stewardship system, also promoted conservatism by focusing on the preservation of feudal estate products.

¹⁴A current edition of the *Wall Street Journal* [Aepfel, 1993, p. A10] provides evidence that German use of secret reserves continues. In a recent effort to become listed on the New York Stock Exchange, a German corporation, Daimler-Benz AG, stated it will declare extraordinary profit of four billion marks (\$2.45 billion) from disclosure of secret reserves. The profit is the result of application of uniform asset valuation methods on the balance sheet.

failure of one institution would impact a host of related companies; thus, disclosure of fraud or ineptitude might result in a chain reaction that would threaten the whole economic system. Bank speculation was flagrant enough in 1927 for the Reichsbank to threaten credit restriction [Northrop, 1938]. The warning went unheeded as both corporations and banks obtained foreign funding. When the foreign supply of credit ceased with the growth of National Socialism, economic collapse occurred [Schmidt, 1934].

Only the failure of the corporate/banking structure to function effectively for the national good brought state intervention resulting in the 1931 Presidential Decree and ensuing amendment to the Company Law requiring audits. The citizenry looked to nationalism and a planned economy for a cure to economic hardship. The public no longer accepted corporate/banking paternalistic expertise and anti-individualism as criteria to maintain the traditional situation of conservation and secrecy. The paper next discusses the dominant accountant groups involved in the emergence of the Presidential Decree and the following legislation.

GROUPS INVOLVED WITH THE PRESIDENTIAL DECREE OF 1931

Following Porter's methodology, the analysis highlights the interaction between primary groups involved with the formation of the Company Law that required mandatory audits. First, this section identifies three main accounting groups, academics, the book examiners and audit companies. Then the analysis explains how the three groups interacted with the political sector in drafting the Company Law that established the new *Wirtschaftsprüfer* profession.

The Evolution of the Book Examiners

The auditing profession evolved through a slow and controversial process. Both Dykxhoorn and Sinning (1989a) and Buchholz (1939a) discuss the emergence of auditors. The book examiner (*vereidigte Bücherrevisor*) originated through the German court system as an expert witness and trustee in liquidation disputes. As with the development of Company Law, Prussia was the leader in accounting and auditing regulation. *Länder* (province) courts originally swore in auditors, but by

1900 the Chambers of Commerce assumed the responsibility for swearing in and appointing book examiners, although they maintained varying admission criteria [van Dien, 1930; Gallhofer and Haslam, 1991].

The Prussians began regulating book auditors as Certified Book Examiners (CBEs) in 1926 [Dykhhoorn and Sinning, 1989a]. An examination served as the means of certification and admission to practice. The Prussian Chamber of Commerce law, which introduced rules for the examination and admission of auditors, served as the regulatory body. Chambers in other *Länder* soon followed the Prussian example [Buchholz, 1939a].

Schourp [1930] and van Dien [1930] assert that accounting groups developed numerous associations to address professional interests.¹⁵ The *Verband deutscher Bücherrevisoren* (V.D.B.), representing certified (sworn-in) auditors, originated in 1896 and became the major accounting organization, besides audit and trust firms, to supply practitioners [Schourp, 1930; Gallhofer and Haslam, 1991; Buchholz, 1939a]. Besides requiring that the applicant be certified by a chamber of commerce or other official authority, the V.D.B. required that the potential member pass an examination given either through the certification process, the Leipzig Commerce College or by the V.D.B. itself [van Dien, 1930; Schourp, 1930].

Audit and Trust Companies

The most powerful group of accountants that competed with the book examiners for control of the profession were the bank auditors. Bank auditors became an effective force through large audit and trust firms, the *Treuhandgesellschaften*. Banks first created the companies in the beginning of the twentieth century to obtain financial information for credit decisions and for monitoring the operations of their obligees. Dykhhoorn and Sinning [1989a] and Schourp [1930] cite as an example the founding by the Deutsche Bank of the *Deutsche Treuhandgesellschaft*, a public accounting firm that is still in existence today.

Buchholz [1939a] adds that with growing industrialization and increasing demands for audits, joint-stock audit firms de-

¹⁵Locke [1984], however, maintains that the early German accounting profession had no powerful cohesive associations, as did the British, to regulate the occupation. German organizations were more like collegial brotherhoods whose members possessed similar occupational and educational backgrounds.

veloped that were independent from the banks. The book examiners (*vereidigte Bücherrevisoren*), perhaps a remnant of German liberalism, urged the development of an auditing profession independent from other businesses, i.e., the banks [Dykhorn and Sinning, 1989a]. The predominant universals of protective nationalism and paternalism, inherent in German cooperative capitalism, however, supported the bank/cartel relationship and the existence of the bank-controlled audit firms. While van Dien [1930] asserts that bank influence on auditors had ended by the late 1920s, Forrester [1984] concludes that the banks never lost control, even after WWII.

The *Treuhandgesellschaften* also founded an organization, the *Verband Deutscher Treuhand-und Revisionsgesellschaften* (V.D.T.R.), in 1919 to promote mutual interests of bank audit firms. By 1929, this group consisted of approximately 80 audit and trust firms [van Dien, 1930, p. 16].

The Role of German Academics in the Accounting Profession

Academics influenced both book examiners and bank auditors in molding the German accounting profession. Locke [1984, p. 215] concludes that academics “were the driving force behind the discipline.” They developed accounting theory, devised curricula, instructed the practitioners and were influential in the auditing profession. Academics joined both the V.D.B. and the V.D.T.R.¹⁶

Locke [1984] concludes that in Europe the greatest professional impact on business management occurred in Germany, and mainly through the accounting profession. Abel [1971] notes that accounting was included in the discipline of business economics (*Betriebswirtschaftslehre*). Business management and accountants did not receive their education at universities but at commerce colleges, which initially taught a form of cameralist administration. The first commercial college was established in 1898 at Leipzig and the second in Cologne in 1901 [Locke, 1984]. Other colleges became established in major German cities from 1901 to 1919 [Forrester, 1977].

¹⁶Van Dien [1930] notes that accountants frequently belonged to more than one organization and that most auditors who were members in local associations also belonged to the V.D.B. These smaller organizations probably were not effective in instituting changes within the profession.

Leading professionals, such as Schmalenbach and Bünger, perceived of college as the means to standardize knowledge and to achieve status through public recognition as a technical expert [Schourp, 1930; Voss, 1930]. Schourp [1930] implied that practitioners who received no accounting training, except through apprenticeship, were considered inferior to those with specialized academic backgrounds.

By 1926, standardization became legitimized when legislation instituted a uniform exam for CBEs which was graded by a board that consisted of at least two members of the V.D.B. [van Dien, 1930; Schourp, 1930].¹⁷ Although a college education was never a condition for admission to the profession *per se*, an aspirant practically required a college education to pass the exam.

Accounting academics both exemplified and sustained German ideology. Abercrombie *et al.* [1986] argue that education serves as a primary means of introducing and maintaining a dominant philosophy of a nation. Business economics, emerging from the discipline of cameralist administration in the universities, sanctioned nationalistic protectionism in industry. The accounting emphasis on expertise reflected German Romantic individualism that stressed the human intellect. The existence of business economics at the German colleges, in particular the specialized accounting program at Leipzig, and German societal regard for professional expertise were primary factors in enabling the accounting profession to be so influential in industry.

The Influence of the Three Groups on the 1931 Decree

Academics, book examiners and bank auditors interacted through conflict, then compromise, to establish the new exclusive tier, the *Wirtschaftsprüfer*. The newly approved auditors were those who had a power base through the V.D.B. and the *Treuhandgesellschaften*.¹⁸ These two groups already had demonstrated proficiency and had a large share of the audit clients.

While most factions of the profession united to champion standardized educational requirements among the *Länder*

¹⁷Note that the U.S. certification exam first appeared in 1896 just prior to the turn of the twentieth century, but was not uniform across all states until 1952 [Carey, 1969].

¹⁸Academics were also prevalent in the new profession. Government statistics as of June 30, 1938, report that out of 1126 *Wirtschaftsprüfer* 568 (50.4%) were academicians [Buchholz, 1939a, p. 122].

[Locke, 1984; Graves, 1987; Bünger, 1926], hostility between the CBEs and the bank-controlled audit companies hampered a consolidated effort to promote mandatory audits [Dykhhoorn and Sinning, 1989a]. Dykhhoorn and Sinning [1989a] explain that while the CBEs and the independent *Treuhandgesellschaften*, both desiring to expand their list of clients, supported mandatory audits for all stock companies, the *Kreditbanken* opposed the compulsory examinations. Bankers, who frequently were also shareholders and directors of major corporations, feared losing control of management through disclosure and external audits.

By 1929, however, the V.D.B. and the bank auditors had compromised sufficiently to propose a bill that would merge the two audit groups into one profession, that of the “Public Accountant and Trustee” (*Revisor und Treuhänder*) [van Dien, 1930], later to become the *Wirtschaftsprüfer*.¹⁹ Despite the attempt in the 1920s at self-regulation, van Dien [1930] and Grossmann [1930], recognizing professional internal conflict, predicted that the German legislature would never adopt the Bill. The drafters themselves were not completely satisfied with the results and many *Länder* still opposed a unified profession. Most of the admission and professional regulations, however, included in the newly proposed bill were the same as those finally instituted in the 1931 Presidential Decree.

Although reflective of an increasing German propensity towards nationalism, the 1931 Decree and ensuing legislation also provided evidence of professionally advocated self-regulation that employed federal licensing and a dual system of supervision. The law divided the responsibility for monitoring the profession between the government Chambers of Commerce and a new professional organization, the *Institut der Wirtschaftsprüfer* (IdW).²⁰ The Chambers appointed *Wirtschaftsprüfer* and forwarded complaints to admissions boards that investigated and tried cases [Voss, 1933]. Later the WP Chamber of Auditors (*Wirtschaftsprüferkammer*) became the public sector organization responsible for oversight of and disciplinary action against

¹⁹Van Dien [1930] notes that the original draft was in existence as early as 1926.

²⁰The profession, not waiting for federal enactment, founded a national association in 1930, the National Institute of Auditing and Trustee Work [Forrester, 1977 and Lück, 1984]. The national association established in 1930 was the predecessor to the IdW.

members of the profession [Dykhhoorn and Sinning, 1981]. The IdW represented the *Wirtschaftsprüfer* on matters of standard setting, self-regulation and public accounting affairs [Voss, 1933]. Buchholz [1939a, p. 117] referred to the IdW as the “. . . overall professional check.” The monitoring function of the two organizations became practically inseparable and indiscernible. As Dykhhoorn and Sinning [1981] explain, the affiliation between the IdW and the *Wirtschaftsprüferkammer*, is extremely close even today. Both main offices are housed in the same building in Düsseldorf.

By 1937, an amended Company Law officially ranked the CBEs at a middle tier, below the prestigious *Wirtschaftsprüfer*. While both groups competed for general accounting services, only the elite *Wirtschaftsprüfer* could perform the mandatory audits of stock corporations after implementation of the 1931 Company Law [Buchholz, 1939a; Voss, 1933]. In 1933, the National Socialist Federal Rights Union (NSRB) dissolved the V.D.B. A newly formed *Institut der Wirtschaftsprüfer* had replaced the V.D.B. as the representative organization of accountants.

Although German accountants emphasized technical expertise as a means of fostering objectivity in financial reporting, they lacked the organizational cohesiveness to promote uniformity in accounting principles [Voss, 1933; Singer, 1943]. The crusade for uniform cost accounting to enhance national productivity never carried over extensively to financial reporting [Abel, 1971; Singer, 1943]. Lack of widespread corporate ownership and government confidence in the corporate/banking alliance precluded national interest in standardization of financial accounting. The 1931 Company Law was generally vague regarding implementation of accounting principles such as “reasonable” depreciation and “fair” value of assets [Voss, 1933]. Additionally, few auditing rules existed. Even after the 1931 Presidential Decree establishing the WP, the profession’s representative organization, the IdW, provided little guidance on the issuance of audit reports or on conducting examinations [Voss, 1933; Niehus, 1969].

The originally drafted bill demonstrated that, despite internal conflicts, the auditing profession, not the German government bureaucracy, initiated professional regulation. Buchholz [1939b] and Schourp [1930] depicted the profession as independent (auditors were never civil servants), but accepting of the

State through national regulation. Only the lack of cohesiveness among the book examiners and the bank auditors, and a government preoccupied with overwhelming economic issues had delayed legislation until the economic crises of the early 1930s. While disclosure was more defined than under previous codes, protectionism and conservatism were still in evidence. The Government still operating under a penchant for secrecy continued to condone secret reserves [Semler, 1938].

The Permeation of Nationalism, Paternalism and Anti-individualism in the German Accounting Profession

German capitalism might be best described as cooperative capitalism. The private sector produced the goods and services while the State condoned consolidation to ensure economic stability and the nation's well being. Germans did not eulogize market competition, which they regarded as inefficient and destructive, engendering conflict not consensus. German nationalism created a climate conducive to cartelization and the use of accounting as a tool to promote economic stability and to enable those who controlled cartels to accumulate capital.

German paternalism made acceptance of cartels possible and industrialists' and bankers' claims, that they subordinated their own interests to society's, plausible. The cameralist tradition, exhibited in the commerce colleges, reflected the spirit of *noblesse oblige*. Nationalism, paternalism and Romantic individualism enjoined Germans to work for the common good; resulting in cooperative capitalism that formed an ideological framework under which the institutions of cartels, banks and the accounting profession operated. A harmony of interests between the *Kreditbanken* and the cartels and a lack of concern for individual property rights, precluded a concern for minority shareholders, financial disclosure, and independent monitoring.

Education reinforced the concept of paternalism and Romantic individualism, by permitting individuals to develop their minds and talents to improve society through technical expertise. The German accounting profession promoted expertise as its predominate attribute. The introduction of business economics, *Betriebswirtschaftslehre*, into the commercial colleges contributed to the standardization of accounting education, and empowered the accounting profession to assume the role of "expert" in the business community. Accounting served as the tool to gauge efficiency. Despite emphasizing technical expertise and

standardized rules as goals in financial accounting, however, no uniform professional auditing standards existed in Germany until the 1930s.

By the 1930s, the German accounting profession was just beginning to emerge from a nascent state. Practitioners sought to gain professional status and influence through enhanced education and federal licensing. Evolution towards professional maturity was exemplified by the fact that by the late 1920s, German accountants had drafted legislation not only mandating audits, but establishing an elite national profession. The lack of cohesiveness, however, commonly found in the early stages of group evolution, prevented the German profession from uniting to achieve legislative recognition until the economic crises of the 1930s. Nationalism, by then more completely entrenched in German politics, became evident in federal licensing and by 1931 resulted in a unified profession under the IdW.

CONCLUSION

The emergence of the German accounting profession shows that the cultural attributes described by Abercrombie *et al.* [1986] provide explanations of political actions. The lack of competitive market forces *per se* does not imply a corresponding lack of demand for audits or the absence of an accounting profession. Without widespread stock ownership and a free market to allocate resources, monitoring of management operations can be provided by other methods. In the case of Germany, bank auditors furnished this mechanism until economic crises proved internal examinations suspect.

This study concurs with Abel's [1971] conclusion that business reforms evolve only if economic needs arise. Economic crisis, not the nascent accounting profession, resulted in legislative action mandating audits. The emerging accounting profession was not capable of successfully confronting the existent corporate/banking alliance to significantly impact financial reporting or the demand for audits.

The role of the German banks, not only as creditors, shareholders and speculators, but as interlocking directors of cartels, meant the economic collapse of one institution, the banks, affected the other, the cartels. The German government could no longer continue a hands-off approach. Secrecy no longer functioned to maintain stability but had resulted in financial collapse. Independent monitoring became mandatory to protect

the nation, but Germany had to look to the expertise of the public accounting profession for the watch-dog mechanism, now acquiescent towards national regulation. The economic crises of the 1930s precipitated federal legislation, but the propensity in Germany to focus on communality made national control acceptable to the members of the accounting profession.

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