

# Formation of the Departmental Committee on Company Law Amendment and F.R.M. de Paula's Appointment to the ICAEW Council

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## I. Introduction

The Recommendations on Accounting Principles (ROAPs) were 29 statements drafted by the Taxation and Financial Relations Committee (T&FRC) and issued by the Parliamentary and Law Committee (P&LC) or by the Council of the Institute of Chartered Accountants in England and Wales (ICAEW) between 1942 and 1969. They allegedly aimed at setting forth practical guidelines for audits for the members. The recommendations up to 1944 had a tremendous impact on the company law reform of 1947 (Edey, 1950). Many researchers now interpret the publication of the ROAPs as being significant to disclose information useful for investor decision-making (*Accountancy*, August 1945).

This event deserves to be considered an essential landmark in British accounting history. Previously, the main role of accounting

disclosure was to have company directors fulfill the charge as fiduciary to the companies' business for shareholders. Features of the practice lay in individualistic disclosure systems in the period of Laissez-faire economics (Chiba, 1991: 322).

A factor that contributed to this radical change in the ICAEW's opinion and the publication of the ROAPs was the Royal Mail Case (1931) (De Paula and De Paula, 1957: vi-vii). However, it is questionable whether this change had been "directly" influenced by the Royal Mail Case. Previous accounting conceptions still held vigorous sway with the ICAEW during the period immediately following the case. In spite of much criticism, especially from the Society of Incorporated Accountants and Auditors, the leading Council members of the ICAEW had accepted the conventional role of accounting disclosure and had emphasised individualistic disclosure systems (Noguchi, 1993).

One theme emerges as a topic for fresh consideration: What immediate factors guided the change in the ICAEW's opinion from the Royal Mail Case to the publication of the ROAPs? Immediate factors other than the Royal Mail Case must have existed. In order to understand the company law reform of 1947, one must be aware of the other factors.

In late 1943, a great change occurred. The Council members of the ICAEW let F.R.M. de Paula join them. F.R.M. de Paula had a profound knowledge of accounting principles and played a significant role in the draft and publication of the ROAPs (Noguchi, 1994). There must have been compelling reasons that lead to the Council members' decision because they had been staunchly opposed to formulating accounting principles until then.

This paper intends to explain compelling reasons that lead to the Council members' decision to let F.R.M. de Paula join them.

## II. Formation of the Departmental Committee on Company Law Amendment

On June 26, 1943, Hugh Dalton, President of the Board of Trade (BOT), which took responsibility for reviewing company law, appointed a departmental committee with the following general terms of reference: "To consider and report what major amendments are desirable in the Companies Act, 1929, and in particular to review the requirements prescribed in regard to the formation and affairs of companies and the safeguards afforded for investors and for the public interest." This was the Departmental Committee on Company Law Amendment known as the Cohen Committee.<sup>(1)</sup>

It is interesting to note that a similar committee (the Greene Committee, the report of which formed the basis for the Companies Act of 1929), appointed in 1925, consisted of twelve members including two members of the accountancy profession, William Cash and the late Sir James Martin, whereas the 1943 committee had thirteen members but included only one accountant, Russell Kettle.

*The Accountant* (3 July 1943) reported about the Cohen Committee as follows: "Since the passing of the Companies Act, 1929, many loopholes and anomalies in the law have come to light, and the course of industrial development—to give but one example, the growth of large combines and the resulting call for greater publicity in accounts—has led to a constant and increasing demand for a further investigation of the existing legislation, with a view to further reform."

"The BOT believed that the time was right for an extension of management's accountability and, in choosing the committee's membership, took care to include people who were likely to be sympathetic to new ideas," according to J. R. Edwards (1989: 207).

The idea to set up a departmental committee to reform company law originated from the suggestion by Sir Edward Hodgson,

Second Secretary, to Dalton on December 22, 1942. Hodgson emphasised his idea in the suggestion as follows:

The experience of the department...strongly suggests that the law should be strengthened to provide greater publicity in regard to the formation and affairs of a limited liability company and for better safeguards for investors and shareholders...There has also been a growing claim that the interests of the community, as distinct from those of the shareholders, should have more recognition in the formation and conduct of a corporation (Bircher, 1988).

Then, Hodgson himself was appointed to the Cohen Committee. Indeed, it was said that the matter was not whether reform should be made or not, but how far improvements could be incorporated into legislative form. As Paul Bircher (1988) described it, "The principal battle for change in accounting practice however had been won in the establishment of the committee of inquiry."

### III. ICAEW's Response to the Formation of the Cohen Committee

In March 1943, the BOT was looking for persons suitable for the departmental committee to reform company law. The ICAEW Council sensed the BOT's intention to reform company law and, on March 29, 1943, planned to set up a sub-committee on company law reform in the P&LC to counter the BOT's proposed revisions. This sub-committee was to consist of the chairman of the P&LC, the ICAEW President and Vice President, R. N. Carter, R. Kettle, T. B. Robson, and R. E. Yeabsley (Bircher, 1991: 241). Later Kettle was replaced due to his appointment to the Cohen Committee.

Almost all members of the sub-committee were Council members of the ICAEW. There was no close link between this sub-committee and the T&FRC as is indicated in their constitutions (*The*

*Accountant*, 1 August 1942 and 12 June 1943<sup>(2)</sup>). Although the T&FRC, the vice-chairman of which was F.R.M. de Paula, had been formed and some ROAPs had been published already, the ICAEW Council planned to set up a separate organisation from the T&FRC.

In reality, the Council members of the ICAEW had accepted previous accounting conceptions and had been staunchly opposed to formulating accounting principles until mid-1943. Their intention was to deny the significance of prescribed form and contents of accounts in order to eliminate government's intervention in auditing procedures (Noguchi, 1996). Thus, the P&LC sub-committee was expected to oppose detailed regulation on reforming company law at this time.

However, after the announcement of the BOT's determination and formation of the Cohen Committee, the ICAEW's attitude suddenly changed. Sir Harold Howitt was appointed to the P&LC sub-committee without delay. He prepared the ICAEW's Memorandum of Evidence and gave verbal evidence to the Cohen Committee on behalf of the Council on December 31, 1943. Howitt was Harold Barton's confidant (*The Accountant*, 17 June 1944<sup>(3)</sup>). Barton himself was an advocate of the formation of the T&FRC and the first chairman (*The Accountant*, 30 May 1942). Howitt's appointment linked the P&LC sub-committee to the T&FRC.

Indeed, the part "Head 8. Accounts, (3) Contents of Balance Sheets, (j) Reserves and Provisions" of the Memorandum and ROAP No.6 "Reserves and Provisions" had similar contents (*The Accountant*, 23 October 1943 and 10 June 1944). The ICAEW's attitude toward accounting disclosure was expressed in the Memorandum as follows:

The Institute is in favour of the maximum practicable disclosure of information in annual accounts and suggests that any recommendations which the Committee may make for the amendment of the existing law should not be in

such terms as to encourage directors of companies to furnish only the minimum of information prescribed, or to be prescribed, by Parliament or to discourage initiative in devising new and better methods of presenting accounting information (*The Accountant*, 10 June 1944).

The Council members accepted the significance of prescribed form and contents of accounts while leaving room for company directors to devise better individual ways to disclose accounting information. When Howitt was appointed to the P&LC sub-committee, the Council members of the ICAEW gave up previous accounting conceptions and rather positively wanted to take the initiative in reforming company law by taking advantage of Kettle's appointment to the Cohen Committee in order to maintain their influence (Bircher, 1991: 241-2).

#### **IV. F.R.M. de Paula's Appointment to the ICAEW Council**

On June 30, 1943, a memorandum containing ROAP No.6 "Reserves and Provisions" was submitted to the P&LC by the T&FRC. However, the P&LC considered postponing dealing with suggestions made by the T&FRC to wait for the report from the Cohen Committee (Bircher, 1991: 240). Another P&LC meeting was held on July 19, 1943 to further consider the risks of issuing ROAPs. The P&LC members, who were all Council members of the ICAEW, had a vote on whether or not the views of the president of the BOT and Justice Cohen should be sought before issuing any further ROAPs. The vote was lost seven to eight and ROAP No.6 was published on October 23, 1943.

Prior to the publication of ROAP No.6, the P&LC members closely observed the Cohen Committee. They were cautious not to be too hasty in promoting their recommendations because they thought that they might conflict with the upcoming report from the

Cohen Committee and feared that they might lose their monopolistic influence on auditing procedures.

Some factors contributed to their decision to urgently issue ROAP No.6. ROAP No.6 was related to reserves and provisions. Since it was the main topic in the Royal Mail Case, it was easy to arouse sympathy about the contents of the recommendation and it was likely to give an impact on company law reform. Moreover, forceful enough reasons to convince the Cohen Committee of their competence were necessary for the Council members of the ICAEW to take the initiative in reforming company law. Still, there was not much time because the Cohen Committee had already started to hear from sources other than the ICAEW (*The Accountant*, 31 July and 25 September 1943). The Council members felt an urgency to act.

This urgency also contributed to the Council members' decision to let F.R.M. de Paula join them. *The Accountant* published his article "The Future of the Accountancy Profession" on May 8, 1943. Quoting the City Notes in *The Times* of March 8, 1943, de Paula (1943) expressed his opinion as follows:

It would seem most desirable that the present attempt to build up a code of accepted accounting principles should be developed so far as is possible for the benefit of the profession and that accountants should use their influence towards improving the form of presentation of accounts. The extraordinary diversity of opinion and practice of individual accountants is, I suggest, the weakest point in the present position of the profession...A revision of the Companies Act, I suggest, is long overdue. It would seem to be prudent, therefore, for the profession to commence consideration of what its recommendations are to be when the Act is in course of revision.

This opinion coincided with the Council members' desire to maintain their influence by taking the initiative in reforming company law. F.R.M. de Paula was more than just a man who had a

profound knowledge of accounting principles. He was a charismatic leader who knew how to initiate change! In the same article, he indicated some effective accounting principles that would help the Council members maintain advantage reforming company law (De Paula, 1943). The accounting principles he advocated were convincing to the Council members and, in fact, later became ROAPs, including pivotal ROAP No.6, which came out before the publication of the report from the Cohen Committee.

The Council members of the ICAEW felt an urgency to act, but they did not have enough experience to formulate effective accounting principles to take the initiative in reforming company law. Therefore, the Council members let F.R.M. de Paula join them in order to promote the formulation of those kinds of accounting principles (Kitchen and Parker, 1980: 96-7). This interpretation of the event can be supported by the energetic activities and the extension of the constitution of the T&FRC which occurred during the next couple of years (Zeff, 1972: 13; *The Accountant*, 1 July 1944).

## V. Conclusion

This paper intended to explain compelling reasons that lead to the ICAEW Council members' decision to let F.R.M. de Paula join them.

The Council members of the ICAEW let F.R.M. de Paula join them because they felt an urgency to take the initiative in reforming company law and de Paula had the necessary experience to expedite the formulation of effective accounting principles and to realise the Council members' desire to maintain their influence. The success of the ROAPs and their impact on the Cohen Committee's report, which formed the basis of the company law reform of 1947, was no accident. It was shrewdly plotted from the start.



[Notes]

- (1) The members of the committee were: Chairman, Mr Justice Cohen; Mr Basil G. Catterns, Deputy Governor of the Bank of England; Mr Arthur F. B. fforde, a member of the firm of Linklaters and Paines, solicitors; Mr Montagu L. Gedge, barrister-at-law, a member of the Chancery Bar; Professor Arthur L. Goodhart, K. C., Professor of Jurisprudence at Oxford, Editor of *Law Quarterly Review*; Mr Geoffrey Heyworth, chairman of Lever Brothers and Unilever Ltd.; Sir Edward Hodgson, C. B., O. B. E., second secretary of the Board of Trade; Mr Russell Kettle, F. C. A., a member of the firm of Deloitte, Plender, Griffiths & Co., Accountants; Col. Harold P. Mitchell, Member of Parliament for Brentford and Chiswick; Mr George W. Thomson, a member of the General Council of the T. U. C., President of the National Federation of Professional Workers; Mr Laurence H. Watson, M. C., K. C., a member of the Scottish Bar and Home Advocate Depute; Mr Robert P. Wilkinson, deputy chairman of the Stock Exchange; Mr John Wilmot, Member of Parliament for Kennington.
- (2) Harold Barton was already Vice President of the ICAEW. But reelection of President and Vice President was to be done in June. So, Vice President in the P&LC sub-committee did not mean Barton when the plan was made.
- (3) Harold Barton and Harold Howitt were elected President and Vice President of the ICAEW respectively at the meeting of the Council on June 7, 1944. In his inaugural speech, Howitt expressed his view about Barton as follows: "I consider myself extremely fortunate that I should be called into this Vice-Chair in a period when Mr. Harold Barton is President. I can think of no one, if he will promise not to listen while I say so, under whom I would more willingly serve. He and I are old hands at this game, so to speak, in that many years ago we occupied comparable positions: he was Chairman and I was Vice-Chairman of the London Members' Committee, so I think we know how to get on with each other. Speaking for myself, I respect him tremendously, and shall be most happy to work for him, and therefore for the good of the great

profession which we all have at heart.”

- (4) The notes said: “It has been said that professional organisations always tend to wait upon the law and upon public opinion to lay down for them the principles which should govern their professional practices; that instead of leading the way in the formulation of desirable reforms, they allow themselves to be led. This no doubt is a gross libel. But there is enough truth in it to make it worth while for those professional bodies which are concerned with company affairs to start making up their minds and expressing their considered views about a number of such matters. They could thus pave the way for the next amendment of the Companies Acts.”

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This paper intends to explain compelling reasons that lead to the ICAEW Council members' decision to let F.R.M. de Paula join them.

On June 26, 1943, Hugh Dalton, President of the Board of Trade (BOT), appointed a departmental committee to reform company law known as the Cohen Committee. The BOT had a definite desire to thoroughly reform company law and to establish detailed regulation on publicity in accounts.

The Council of the Institute of Chartered Accountants in England and Wales (ICAEW) planned to set up a sub-committee on company law reform in the Parliamentary and Law Committee (P&LC) to counter the BOT's proposed revisions. Thus, the P&LC sub-committee was expected to oppose detailed regulation on reforming company law at first.

However, after the announcement of the BOT's determination and formation of the Cohen Committee, the ICAEW's attitude suddenly changed. The Council members of the ICAEW accepted the BOT's proposed revisions and rather positively wanted to take the initiative in reforming company law in order to maintain their influence.

Forceful enough reasons to convince the Cohen Committee of their competence were necessary for the Council members of the ICAEW to take the initiative in reforming company law. Still, there was not much time because the Cohen Committee had already started to hear from sources other than the ICAEW. The Council members felt an urgency to act, but they did not have enough experience to formulate effective accounting

principles to take the initiative in reforming company law.

Therefore, the Council members of the ICAEW let F.R.M. de Paula join them in order to promote the formulation of those kinds of accounting principles. F.R.M. de Paula was more than just a man who had a profound knowledge of accounting principles. He was a charismatic leader who knew how to initiate change!

The Council members of the ICAEW let F.R.M. de Paula join them because they felt an urgency to take the initiative in reforming company law and de Paula had the necessary experience to expedite the formulation of effective accounting principles and to realise the Council members' desire to maintain their influence.