DISCUSSION

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The Finnish Accounting History

The Development from the Early Accounting Practice to the First Accounting Act

ABSTRACT

The focus of this paper is on the accounting history in Finland. The accounting textbooks published in Finnish in the 1800th century are presented as well as the first accounting regulation in 1925. Based on the original books and documents the paper presents the early accounting thinkers, the first regulation, and the development of accounting principles in Finland. In a sense the accounting philosophy is on the way back to the early beginning. In the time of Lilius the money in use was the Russian Rouble; now the money is the European Euro. In the end of the 1800th century Finland was a part of Russia; now it is the part of Europe. Moreover; the theoretical framework of A. Lilius in 1862 was the same as that of IAS/IFRS. Some accounting principles developed by the early accounting thinkers in 1800th century will be back with the harmonization.

Key words: *financial accounting, history, the early practice, the regulation, IAS/IFRS*

1. Introduction

In Finland the accounting history is not a common study issue, and the early practice of Finnish accounting is not well known (Grandell 1989; Kettunen 1983, 1993; Näsi 1990). The location of Finland is very distant in the Northern Europe, between Europe and Russia. The cultural, linguistic, political, economic and de-

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mographic factors have been of great importance in the national accounting development (Belkaoui 1985; Kettunen 1993). Therefore the Finnish accounting practice and history is extraordinary (Kettunen 1993; Lukka & Pihlanto 1994). In this paper the focus is on the early accounting history in Finland. The main purpose is to present the first accounting text books published in Finnish in the 1800th century, in the beginning of the 1900th century and the first accounting regulation in 1925.

Why should the issue of accounting history be important and interesting to study? To the first, the accounting today is in a powerful changing process. The IAS/IFRS will harmonize the accounting practice, and the national accounting tradition will disappear very soon. Understanding the past is important to understanding the present and the future. Knowing the past accounting is necessary in comprehending the solutions of new accounting norms. To the second, in the busy world it's worthy to go back to the first accounting records. Accounting tells not only about the transactions of the firm but about the time and country they have taken place. As the double entry bookkeeping played a crucial role in Italian merchants' superior trading knowledge, the accounting skills in Finland were an important benefit in keeping ordinance in the trading house and in helping the merchant in his business. To the third, the men who created the accounting practice in Finland deserve to get their own history writing (Kindleberger 1993; North 1990; Kelly 1821; acct.tamu.edu/Giroux/Britain.html; Näsi 1990; Näsi & Näsi 1997).

The paper consists of three sections. The first section describes the first Finnish accounting thinkers of the nineteenth century and their main ideas. In the next section the implications of the regulation in 1925 are introduced. The third section discusses the differences and the similarities between the first accounting practice and legislation and with the IAS/IFRS.

The study constitutes a qualitative historical study of accounting. The object is to understand the accounting thinking and to identify and explicate the accounting principles in the 1800th century. On the other hand the matter is about history. The study describes the evolution of the accounting thought and practice (Belkaoui 1992). Based on the original books and documents the paper presents the early accounting practice and the development of the accounting principles in Finland.

2 The accounting practice was before the regulation

2.1 Finland in the 1800th and in the beginning of the 1900th century

In 1809 Finland separated from Sweden and became a self-governing part of Russia. Many big changes in the culture, the political life and the business life were taken place. The economy historians call the period from end of the 1800th century to the First World War the first industrialization period. The trade and commerce revived and became livelier. The basic structure of the society broke down; the agriculture was replaced by the industry and factories. The estate society fell and the new enterprise freedom gave citizens an opportunity to change their lives (Kuusi 1920; Rasila 1982b).

Especially in the 1860's and the 1870's the industry and the commerce developed enormously. The steam power was taken to use and the lumber industry spread out on the river sides all around the country. At the same time the

Finnish paper industry arose, and the forest industry and the dairying grew up. Railways and water ways offered suitable trade routes (Kuusi 1920; Rasila 1982b).

The companies were able to collect share capital when the first Companies' Act was passed. It was easy to get loans when many new banks were founded in the country. In the year 1860 the Russian tsar permitted Finland their own money, the Finnish Mark. After that the money economy became more stable, and was not connected with the value of the Russian Rouble any longer (Rasila 1982a; Rasila 1982b; Kuusterä 1991; www.kulttuuri.kuopio.fi/ museo/ Snellman/ suomenmarkka).

In this critical period of the society and the economy the first Finnish accounting textbook was published in 1862; *The Practical Introduction to the Simple Accounting Especially for the Industry and Commerce Enterprisers* by August Lilius. The meaning of the book was to help the traders to clear up their receivables and loans, as well as the amount of their property (Lilius 1862; Kettunen 1983; Näsi 1990).

2.2 August Lilius

The accounting is that I, according to the certain rules, write into the book all the changes of my property in my trading house (Lilius 1862).

Lilius can be called the father of bookkeeping in Finland like Luca Pacioli was the first known name of the accounting in the whole world. Lilius' textbook was written for the need of the merchants; the developed business required systematic and good care of money and other assets. Lilius considered that the purpose of accounting was first of all to keep up the order in the merchants' affair. It was necessary to register the receivables and loans into the notebook, because some of the transactions were not paid in cash. The main purpose of the accounting was *to show, who my creditors are and who my debtors are, and how much my receivables and my liabilities are* (Lilius 1862, Kettunen 1983, Näsi 1990).

The entries were registered using a single, or simple, Italian accounting form. In the bookkeeping there was an account for every creditor and debtor. The title of the account was the name of the creditor or debtor whose receivables or debts were controlled by the account. A real person was behind the account. The task of the accounting was to calculate the amount and the change of the assets. The change of assets was the profit or the loss from the accounting period; *if our property is during the month increased or decreased and how much is to one or the other, the profit or the loss.* The second task was to show the receivables and the liabilities (Kettunen 1983, Lilius 1862).

One significant aspect was that Lilius kept the owner and his property not separated from each other; they were the same entity. In our days this quality may be seen as a sign of the primitive conception. On the other hand it may have been in the 1800th century a natural way to understand the person together with his assets (Kettunen, 1983). Kelly1821 presents the same idea of personal accounts. In Kelly's bookkeeping the person, who receives is Dr (Debtor) and the person who gives or parts with any thing is Cr (Creditor) (Kelly 1821).

2.3 Other early accounting thinkers

After Lilius several Finnish accounting thinkers, like I. Kovero, I.A. Kallioniemi and I.V. Kaitila, contributed to the newborn Finnish accounting theory. On the contrary to the earlier accounting practitioners, Lilius and Sergeeff for example, Kallioniemi (1915) considered that the affair was an entity and the private transactions have to be followed separately from the transactions concerning the firm. Besides the assets and the liabilities, the result of the year should be shown in the balance sheet. The balance sheet was the only financial statement; the profit and loss account was not known at that time (Sergeeff 1897; Kallioniemi 1915).

The receivables, the liabilities and the equity were recorded into bookkeeping. Kovero (1907) mentioned that it could be possible to follow other assets like the securities, the equipment and the property as well. However, these did not require as much attention and the first accounting did not include them. Sometimes, however, it was important to get a general view of the assets and the profit or loss. Therefore it was useful to make an inventory and calculate all the assets and the liabilities and changes of these (Kovero 1907). The transactions were not regarded as revenues and expenses; finally the only influence of them was that they caused an increase or a decrease in equity.

The rules concerning accounting principles were free. The merchant was able to prepare annual accounts using his own needs. The valuation and matching questions were solved using the commercial prudence method (Kettunen 1983; Lilius 1862; Sergeeff 1897; Kovero 1907; Kaitila 1916, 1921). Kaitila gave more detailed instructions; the best way to value assets was to make it on the basis of the future utility from the assets. However, it was not possible to estimate the future use of assets and therefore the only practical way was to calculate them using the fair value; *the price that is expected to get from it now* (Kaitila 1915, 1921).

The problem, however, was to know, what was the fair price of the old and used equipment, and who wanted to pay it. Kaitila presented as a solution making depreciations according to the plan. There are two possible ways to make the depreciations; *to write off every year the same amount per cent from the purchase price or; to write off the same amount per cent from the value in the end of the previous year.* The second one, Kaitila wrote, was not a perfect way because using that way the assets will never disappear from the balance sheet (Kaitila 1916).

The decreases and increases in the value of the assets could be taken into account if there were some unexpected events. For example, if a new substitutive machine was innovated, the old one was not valuable any longer. The accounting principles were not common and emphasized the going concern principle; the solutions concerning the valuation and the matching had to be done using the same rules from year to year (Kaitila 1916).

The valuation of the inventory followed the principle of prudence; the acquisition price or the market price depending on which one was the lowest value. The value might be rather too low than too high. The receivables should follow the prudence principle as well*; if we want to know the assets exactly, it's important to take off the future interests of the claims founded on the bill* (Kovero 1907). The first Companies' Act passed 1895 ordered the same rules of valuation. According to the act, the inventory, which was the name of the annual accounts, had to be prepared for every year. It was allowed to include to the inventory only the certain assets. The assets had to be valued using just values (Kaitila 1915).

2.4 The accounting theory in the 1800th century

The first issue in the 1800th century was the question of accounting entity. Lilius understood the merchant and his affair as an entity; the owner was the same as the assets of the firm. Every transaction that happened in the affair had an influence on the property of the owner. Also the receivables and liabilities were personified to the individual persons. The use of accounting was to serve the owner. The needs and expectations of the owner were the basis of the accounting principles. The purpose was to organize everything the merchant owned and to remember the amount and the changes of his property.

Very soon, however, the firm became separated from the owner in the accounting practice and was considered as an entity. Into the accounting were included the accounts for the transactions of the private economy. Still the accounting was done only for the owner and for his property. He could decide which items and transactions were material and should be included into bookkeeping. The general rule was that transactions which caused changes in the assets of the owner were relevance and material.

The other issues to be solved were the valuation and matching rules. The main principle in practice was the commercial prudence applying in accordance with the situation. The purpose of accounting was to calculate and remember the property of the merchant. Therefore it was practical to make the valuation using the real price and not to underestimate or overestimate the assets. It was clever to expect the future rather too pessimistic than too optimistic. Anyway, the implication of the valuation was well understood as early as that. The writers of the 1800th century mentioned that using different valuation rules it was easy to give different views of the inventory.

The basic idea of accounting was to use only some accounts for the assets, the liabilities and the owners' equity. In the beginning and the end of the financial period was calculated the amount of the property. The change in the property was the result of the business. The idea is today known as the theoretical framework called the accounting equity theory.

The early accounting practitioners had thought over the issues which are topical still today, and have solved many theoretical issues of accounting. The principles of going concern, of valuation, of matching and of prudence were known (Järvinen et. al. 2000). The purpose of the accounting was to keep a watch over the personal wealth of the owner, and the balance sheet was supposed to give the real view of the wealthy position of the owner.

In the 1800th century the world around the firm was very limited. The only important stakeholder outside the firm was the lenders Nobody except the owner was usually interested in accounting. In fact the owner was not accountability to somebody else. Into the first Accounting Act in 1925 were included the existing practice. However the regulation was the beginning of the public control of the merchants' affair.

3 The accounting regulation

3.1 The first accounting act in 1925

The first decades of the 1900th century were chaotic in Finland. Finland was still an autonomous part of the Tsarist Empire of Russia. After the revolution in Russia 1917 Finland became an independent republic. Finland was for first time in the history a free and independent country. Big political and societal reforms were carried out. The legislation from the Russian period was reformed. The construction of self-governing was expensive and in the same time the civil war and crop failures caused famine and suffering (Näsi 1990; http://www.uta.fi/suomi80).

The Accounting Act had been only an aim of the future in the 1800th century. There were a few references to the accounting obligation in the crime code, the bankruptcy code and in the Companies Act. The first Companies Act passed in 1895 sanctioned the accounting obligatory to the companies. The reason on the accounting obligation was the protection of the lenders. The success or the failure of the company had influence on many persons' lives, not only on the owners'. Three proposals to regulate accounting by an act were made, and the Accounting Obligation Act was passed in 1925 (Kaitila 1916).

3.2 The rules of accounting

The first Accounting Act included simple rules concerning the accounting obligation, the valuation and matching rules, the financial statements and the technique of accounting. The purpose of the accounting was to show the assets and the liabilities and the changes of them as well as the own consumption of goods. In the opening balance sheet had to show the assets and the liabilities. In the end of financial year had to prepare the closing balance sheet and the profit and loss account. The profit and loss account was based on the changes of the assets and the liabilities (Ahvenainen & Vartiainen 1982; Kirjanpitolaki 1925, Näsi 1990).

The detailed valuation rules were given. The main principle was the prudence principle, and the value to be used was the purchasing price or the market price. The lowest one had to be used. An interesting exception was the valuation of the securities; the securities had to present in the balance sheet using the market prise or another fair value. The difference between the historical cost and the fair value was allowed to bring into the assets or into the liabilities. So the revaluation had no impact to the profit or loss for the year (Accounting Act 1925).

A noteworthy detail was that the formation and organization expenses were allowed to present in the balance sheet. This rule includes in the Finnish Accounting Act even today. However, the IAS/IFRS will not permit the capitalization of formation and organization expenses any longer (Accounting Act 1925).

The matching principles were still under the debate and the rules about the issue were minor. The depreciations had to make according to the decrease of the value. Anyway the freedom of accounting practice was still great (Accounting Act 1925).

The Accounting Act was complemented by the Publication of Financial Statements Act a few years later, in 1928. Many issues concerning the accounting practice were still open, and the ethical code of good merchants' practice was given by act in order to develop the right tradition. The act was the first source of accounting and the practice was the other one. In spite of the legislation the practice still constructed good accounting applications (Accounting Act 1925; Publication of Financial Statements Act 1928; Näsi 1990).

The theoretical approach of the first accounting act was the accounting equity theory, and the most important document was still the balance sheet. The profit and loss account was mentioned as a mandatory part of the financial statements. However, there wasn't given any certain format for the profit and loss account. The calculation of the profit or loss for the year was originated on the changes of the balance sheet. The concepts like revenues or expenses were not known.

3.3 The accounting act and the practice

The most important contribution the Accounting Act brought about was the publicity of the bookkeeping (Kettunen 1993). The context of accounting was much wider than some decades before. The user of the balance sheet was not any longer the owner alone, but the shareholders, the lenders and the government needed to get financial information of firm. Since the accounting was sanctioned it became a visible phenomenon and had a new role in the society. Accounting was a link between the firm and the government, and by accounting the government was able to have control over the firms.

The time when the merchant could organize the accounting only for himself was gone, and the Accounting Act sanctioned all the companies to use the same regulation. In add to the primary accounting principles of going concern, valuation, matching and prudence some new ones were born. The first one was the comparability; the users of the accounting information were able to compare the performance and the financial position of companies.

The other new principle was the understandability. Before the legislation the field of accounting was wild, and the merchants could prepare accounts in the way who nobody else understood. Because the accounting was done for a single person, it had no communicative use. Kaitila 1915, for example, recommended adding into the chart of the accounts a secret account in order to make some hidden transactions that even the bookkeeper couldn't find out. Anyway, when the accounting was similar in all the companies, it was understandably and the communicating between the company and the users of the accounting information was possible. The common, comparable, understabile and communicative language of accounting originated from the legislation.

The good merchants' practice was still alive, and the moral principles honesty and exactness were mentioned in the act as well. However, the same rules concerned the accounting principles in the companies limited the owners' dominance over the bookkeeping. The moral reasoning had a new dimension related to the practice; the accountability. The owner was not any longer the lord in the world of accounting. There were others as well, the government, the tax authorities, the auditors, the other companies, the shareholders and the liabilities to which the company had responsibilities.

4 Conclusions

4.1 The future of accounting

The accounting practice is in a process of change as a consequence of internationalization. Two accounting reforms in 1990s was the start of the harmonization of accounting in Finland (Kettunen 1993; Pirinen 1996). From the financial year starting on 1st January 2005, all listed companies will be obligated to prepare their consolidated accounts according to the IAS/IFRS. The time of the Finnish national accounting practice will be gone after that. In autumn 2002 the Ministry of Trade and Industry assigned an IAS Working Group to identify the changes necessitated by the IAS/IFRS to the Accounting Act and the Companies Act as well as to taxation and other legislation and rules. In summer 2003 the Working Group proposed various amendments to Finnish legislation in order to eliminate any deviations from EU directives and IAS/IFRS standards.

The "no prohibition – no compulsion" principle adopted by the working group includes the opinion that basically all parties under the accounting obligation can, if they so desire, prepare both the consolidated and annual accounts according to the IAS/IFRS standards. However, it is obvious that IAS/IFRS will change the accounting practice of the small and not-listed firms as well (Final Report by the IAS Working Group; 2003; Järvinen et al. 2000).

4.2 IAS/IFRS and the early accounting practice

The basic accounting philosophy hasn't changed much since Lilius wrote the first Finnish textbook in 1862. The purpose of financial statements is still to show the assets and liabilities and the profit or loss of the financial year. In a sense the IAS is very similar with the philosophy of Lilius. Even if the change from the merchants' simple bookkeeping to the big and technical accounting information systems has been great, the primary elements are the same. The accounting theory of Lilius and IAS/IFRS is the accounting equation and the balance sheet is the most important accounting document. The issues of measurement, valuation, matching and materiality were well understood in the 1800th century. The Accounting Act in 1925 contributed to the practice the principles of understandability, comparability and relevance.

In the period from the first accounting textbook in 1862 to the IAS/IFRS in 2005 the history of the society and the accounting are shaped together (Appendix A). In the early days of Lilius Finland was a part of Russia and the money in use was the Russian Rouble. Now Finland is a part of the EU and the money is the European Euro. In Lilius' time the merchant had the control over the accounting. Later, when the regulation passed, the society controlled the accounting by giving the rules. ■

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suomenmarkka

http://www.uta.fi/suomi80

APPENDIX A
Some key events of the Finnish history and accounting

1809	The Russian tsar Aleksanteri I conquered Finland
1860	Finland got the own money, the Finnish Mark
1862	Lilius' textbook on accounting was published
1917	Finland became an independent country
1918	The civil war
1925	The first Accounting Act
1928	The Publication of Financial Statements Act
1945	Professor Martti Saario outlined the revenue expense theory
1968	The Companies Income Taxation Act was grounded on the Saarios theory
1973	The Accounting Act was grounded on the Saarios theory
1995	Finland joined EU
1997	The Accounting Act was grounded on EU`s 4. and 7. directive
2002	Euro became to the money of Finland
2005	The IAS/IFRS