

**THE IMPACT ON THE INDEPENDENCE OF ACCOUNTING
REGULATORS OF STRUCTURE, PROCESS AND INPUTS.**

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ABSTRACT

The thesis describes a model of regulatory independence based on the maximisation of certain characteristics and minimisation of others.

The detailed regulation of accounting in the UK has, since 1970 been carried out in the private sector. The fact that this has been allowed to continue would imply that the government is prepared to accept this as the status quo, despite the constitutional anomaly of non-governmental rule-making. The regulation of accounting is not merely technical, but has economic consequences which stretch beyond the capital market.

One of the main justifications for regulatory activity being performed outside of government is that of bringing about independent action. From a review of the theory and practice of regulatory agencies, several key characteristics emerge which it is argued, impact upon the independence of agencies. These characteristics may be grouped under the following headings: motives for agency creation, agency tasks, structure and method of operating.

In order to examine the impact of these characteristics on agencies two main approaches are used, both based upon the regulators and their regulatory environment. Firstly general characteristics of accounting regulatory bodies are examined. Secondly, where specific processes are being studied, the development of two accounting standards, Statements of Standard Accounting Practice (SSAP's) 20 and 22 are used.

From these particular cases it emerges that the regulators appear to have been influenced in their actions by those companies who would be affected by their pronouncements. The role of the government in the process is also significant in that they appear to attempt to influence the outcome of accounting standards in the same way as other participants in the process. The model that is developed is then compared with general independence-influencing theories of regulatory agencies, such as agency

capture, iron triangle and agency life-cycle. It is concluded that the maximisation of the 'independence model' is difficult to achieve, given the inherent pressures affecting the individual characteristics.

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All other efforts and errors represent my own misconceptions or inspiration.

TABLE OF CONTENTS

	Page
<i>Abstract</i>	2
<i>Acknowledgements</i>	4
<i>Table of Contents</i>	5
<i>List of Tables and Figures</i>	8
<i>Plan of the Thesis</i>	10
<i>CHAPTER 1 ACCOUNTING REGULATION AND ITS ENVIRONMENT</i>	12
<hr/>	
INTRODUCTION	12
THE SIGNIFICANCE OF ACCOUNTING REGULATION	20
THE CONSTITUTIONAL ENVIRONMENT	30
SUMMARY	37
<i>CHAPTER 2 AGENCY CLASSIFICATIONS AND CHARACTERISTICS</i>	38
<hr/>	
INTRODUCTION	38
DEFINITIONS	39
CLASSIFICATIONS AND CHARACTERISTICS	40
THE REGULATORY ENVIRONMENT	52
SUMMARY	55
<i>CHAPTER 3 MOTIVES FOR AGENCY CREATION</i>	57
<hr/>	
INTRODUCTION	57
CLASSIFICATIONS OF REGULATION	58
EARLY THEORIES OF AGENCIES	61
MODERN THEORIES	62
FURTHER THEORIES	79
SUMMARY	80

<i>CHAPTER 4 AGENCY TASKS</i>	83
<hr/>	
INTRODUCTION	83
COMPANY LAW AND ACCOUNTING	
STANDARDS	83
EXPERTISE	86
SERVING THE PUBLIC INTEREST	87
SUMMARY	93
 <i>CHAPTER 5 AGENCY FUNDING AND PERSONNEL</i>	 95
<hr/>	
FUNDING	95
PERSONNEL	100
SUMMARY	109
 <i>CHAPTER 6 ACCOUNTABILITY</i>	 111
<hr/>	
INTRODUCTION	111
NEW CONCEPTS OF ACCOUNTABILITY	112
THE ROLE OF ACCOUNTABILITY IN THE	
PRINCIPAL-AGENT MODEL	125
SUMMARY	137
 <i>CHAPTER 7 AGENCY OPERATIONS</i>	 139
<hr/>	
INTRODUCTION	139
THE REGULATORY PROCESS	141
STUDY 1 - SSAP 20	142
STUDY 2 - SSAP 22	151
METHOD OF OPERATIONS	158
SUMMARY	162

CHAPTER 8 THE GOVERNMENT ROLE IN ACCOUNTING REGULATION	164
<hr/>	
INTRODUCTION	164
THE STUDY	165
INTERVIEWS WITH DEPARTMENTS AND AGENCIES	167
GOVERNMENT AS A USER	180
GOVERNMENT REPLIES TO EXPOSURE DRAFTS	182
THE ACCOUNTING STANDARDS ROLE OF THE DTI	186
SUMMARY	189
CHAPTER 9 COMPARISONS, SUMMARY AND CONCLUSIONS	192
<hr/>	
INTRODUCTION	192
AGENCY CAPTURE	192
ARE ACCOUNTING REGULATORS CAPTURED?	195
THE IRON TRIANGLE	196
LIFE CYCLE THEORIES	198
THEORIES OF LOBBYING	201
INDEPENDENCE REVISITED	204
FURTHER RESEARCH	209
REFLECTIONS	214
 <i>References</i>	 217
<i>Appendices</i>	242

LIST OF TABLES AND FIGURES

Table		Page
3.1	Replies to exposure drafts on foreign exchange and goodwill.	68
3.2	The chronological development of SSAP 20.	69
3.3	ASC standards and drafts issued 1977-1983.	70
3.4	CCAB members responding to ED's 16,21 and 27.	74
4.1	Subjects covered by standards and the law.	84
5.1	Funding structure of the ASC.	97
5.2	Funding structure of the FAF.	99
5.3	Analysis of ASC members 1978-1987.	102
7.1	Comparison of ED 27 and SSAP 20.	144
7.2	Categorisation of comment letters received on ED 27.	145
7.3	Translation method preferences expressed in comment letters.	146
7.4	Profit translation method preferences expressed in comment letters.	146
7.5	Offset preferences expressed in comment letters.	147
7.6	Preferences for treatment of inter-company loans expressed in comment letters.	147
7.7	Methods of translation used 1970-71 and 1978-79.	149
7.8	Comparison of ED 20 and SSAP 22.	151
7.9	Categorisation of comment letters received on ED 30.	152
7.10	Preferences expressed in comment letters for accounting treatment of goodwill.	153
7.11	Preferences expressed in comment letters for period of amortisation (years).	153
7.12	Preferences expressed in comment letters for treatment of non-purchased goodwill.	154
7.13	The accounting treatment of goodwill 1968-69, 1975-76 and 1982-83.	156
8.1	Ananalysis of Government replies to Exposure Drafts 1980 to 1990	185

Figure		Page
3.1	The regulation of financial reporting.	58
3.2	International classification of creation and enforcement of accounting rules.	60
6.1	The principal-agent accountability contract.	126

PLAN OF THE THESIS

This thesis represents a study into the structures and processes of private sector accounting regulation in the UK, concentrating primarily on the Accounting Standards Committee. Drawing on theories mainly developed in the contexts of political and administrative science, it attempts to identify those factors which impact upon the independence of private sector regulators. Each of the factors identified is tested against either permanent characteristics of the regulatory body concerned or examples of incidences of regulatory pronouncements. The paucity of research in the UK on this subject could lead to this thesis being seen as a pilot study, pointing the way to future research on the subject.

Chapter 1 commences with an introduction to the institutional structure of private sector accounting regulatory bodies in the UK, tracing their development from 1969 to date. The public policy element of accounting regulation is then explained by reference to the economic consequences of accounting. Finally, the chapter looks at the problem of decision-making outside of the State. Characteristics of regulatory agencies are identified in Chapter 2 from a study of the literature on regulatory agencies, much of which emanates from the US. From this study, certain characteristics are shown to be significant factors which may impact on the independence of regulatory agencies. Those factors will be examined in the following five chapters with a view to indicating their relevance to regulatory independence.

Chapter 3 takes the first of these characteristics, the motives for agency creation and examines it in the context of the development of two UK Accounting Standards. Chapter 4 takes a similar approach, looking at agency tasks both in general and as applied to the same two Accounting Standards. Chapter 5 takes a more general approach, looking at funding and personnel structures over time within each of the three UK accounting regulatory bodies. The corresponding US bodies are also included in order to achieve a wider perspective on these factors. The general approach is continued in Chapter 6 which examines accountability as a factor best evidenced through general characteristics rather than specific pronouncements.

Chapter 7 returns to the development of the two standards to illustrate both the process adopted by regulators and to examine certain of the

external influences on accounting standards. As an actor closely involved in the process, the government's relationship with the regulators is significant. This relationship is examined in Chapter 8 in order to identify the influence that government may have on regulatory outcomes. In the final chapter, the findings of this study are then related to overall theories of regulatory agency behaviour such as agency capture, agency life cycle and iron triangle theories.

My contribution to accounting knowledge through this study is summarised through a reflection on the individual factors and their applicability to the development of a model of regulatory independence. Finally, areas for further research into the accounting regulatory process arising from this study are indicated.

CHAPTER 1

ACCOUNTING REGULATION AND ITS ENVIRONMENT

INTRODUCTION

This chapter commences by looking at the origins of private sector accounting regulation in the UK, briefly tracing the institutional developments from 1969 onwards and examining the background to these changes. The significance of the work of the regulators is explained by the economic consequences of accounting, whereby regulatory decisions affect matters of welfare, behaviour and distribution. Because of these effects, accounting regulation may be seen as a form of public policy-making and therefore subject to political processes, despite taking place outside the public domain. The problems of the exercise of power outside of the state is examined in the final section.

In The Beginning

In the UK, the first accounting standard was issued in 1971 by the Accounting Standards Steering Committee (ASSC). Prior to this, between 1942 and 1969 a series of twenty nine recommendations had been issued by the Institute of Chartered Accountants in England and Wales (ICAEW)¹. Up until that time, the Institute's Council had,

'...stood aloof from its members' accounting and auditing activities, never having published a booklet of guidance statement in the technical field.'
(Zeff 1972 p. 7)

The origin of these initial pronouncements was the Taxation and Financial Relations Committee of the ICAEW, which is described by Zeff (1972) as exceeding its original purpose in seeking and gaining the approval of the Council to draw up drafts of accounting principles.² Whilst admitting that no hard evidence was available, he (Zeff) noted that

¹ These were termed Recommendations on Accounting Principles

² Its' object was to consider matters affecting taxation and the financial relationship of the business community with the Inland Revenue. It was later named the Taxation and Research Committee and in 1984 was again re-named, this time the Technical Advisory Committee to avoid confusion with the newly formed Research Committee.

'informed observers attest to the effectiveness of the Recommendations' (p. 22). Howitt (1966) describes how the substance of some of the earliest Recommendations issued up until 1944, found its way into the report of the Committee on Company Law Amendment and eventually into the Companies Act 1948. There were however many critics of the accounting choices contained within the Recommendations (see Chambers, 1965; Zeff, 1971), with Leach (1981) also noting that they did little to help the auditor to persuade his client to use best accounting practice. However the flexibility allowed in these Recommendations was the price of the 'widespread compliance' described by Edwards (1989 p. 245).³

In addition to the problem of the alternative approaches allowed by the Recommendations, these early attempts at regulation had no mandatory status, they also took a long time to produce and there was no consultation with interested parties (Taylor & Turley, 1986). The latter two problems were a result of the procedures for the development of a Recommendation which meant that the matter was considered by a committee of the Council (of the ICAEW) and finally by the Council itself, which meant that;

'By this time some 300 chartered accountants might have contributed to the preparation of the document in one way or another'.
(Howitt 1966 pp. 103/104)

Despite the existence of a Disciplinary Committee within the ICAEW, the lack of a structure for enforcement of standards has been commented on by Sharp (1971), who noted that

'..it has been rare indeed for any form of technical lapse (as opposed to failure to carry out a duty) to be a matter for disciplinary procedure'
(p. 242)

Notwithstanding the shortcomings of the series of Recommendations, Edwards (1989) describes the popular view of accounting in the mid 1960's as providing a 'reliable statement of a company's financial position' (p. 145). In the event, this view turned out to be short-lived.

³ Although the Economist of 3.6.68 did acknowledge that during the lifetime of the Recommendations, the guidelines were becoming progressively more detailed.

The Change

Although the Recommendations appear to have been well established and generally accepted (if not adhered to), events were to arise in the latter part of the 1960's which meant that a fundamental change was to occur. Taylor and Turley (1986) describe the GEC-AEI take-over in 1968 as the major catalyst for change, but this had followed by some years the unexpected collapse of Rolls Razor despite the the professional press accepting that 'The accounts of Rolls Razor Ltd follow modern practice and are more informative than most.' (Accountancy, 1964 p. 729). Elsewhere, accounting figures were described as 'relatively true rather than absolutely true' (The Economist, 1968). The Leasco-Pergammon affair in 1969 again brought strong criticism of the accounting profession from the press who attacked accountants' reliance on 'integrity and common-sense, guided by occasional statements issued by the various professional institutions' (The Economist, 1969 pp. 43/44). The same article continued by using Pergammon as an example of 'the dangerously hit and miss methods by which company accounts get audited by auditors'.

Pressure appears to have been growing on the ICAEW during this period to instigate some form of change. Renshall (1992) considered a major factor behind the creation of the ASSC to be the complaint to the President by Sir Frank Kearton, the head of Courtaulds, one of the most active of UK company acquirers, that 'his company had been constantly disappointed after an acquisition to find that the biddees audited accounts were not to be relied on.' The open attack in the national press by Professor Stamp (The Times, 1969), although attracting a bitter response from Ronald Leach, then President of the ICAEW, also served to ferment the atmosphere of criticism of accounting.

The final impetus for change may not have been simply the mounting pressure caused by failures of accounting and the adverse public criticism, but the fear of government intervention in the detailed regulation of accounting (Bromwich, 1981; Taylor & Turley, 1986). Following the Pergammon-Leasco affair, this had been openly suggested as a possible cure '...the accountancy profession will seriously have to consider whether more of its 'best practice' rules should not be written into the Companies Act' (The Economist, 1969 pp. 43/44). The danger of government intervention was thought by some to be imminent. Ken Sharp (who

served two terms on the ASC, totalling 11 years) writing in the professional press, felt that, 'had the Institute not acted it is probable that legislation would have been introduced with unseemly haste' (1971 p. 242)⁴. In the event, the Institute did act swiftly, setting up the Accounting Standards Steering Committee (ASSC) in December 1969.

The First Standard Setters

The ASSC came into life with the publication of a 'Statement of Intent on Accounting Standards in the 1970's', by the Council of the ICAEW (1969). This Statement included aims which were a) to narrow the areas of difference and variety in accounting practice and b) to recommend the disclosure of accounting bases and departures from definitive standards. Initially, the ASSC worked under the ultimate authority of the Council of the ICAEW which was named in its constitution as the governing body. This constitution remained as the basis for all constitutions from 1970 to 1976, amendments being those relating to membership. Initially, the President of the ICAEW appointed Committee members with two places being reserved for Institute of Chartered Accountants in Scotland (ICAS) and Institute of Chartered Accountants in Ireland (ICAI) members⁵. The Association of Certified Accountants (ACCA) and the Institute of Cost and Management Accountants (ICMA) joined in 1971, and the Chartered Institute of Public Finance and Accountancy (CIPFA) in 1976.

As a committee of the ICAEW, the ASSC was served by various other Institute Committees such as the Parliamentary and Law Committee, the Technical Committee and the Technical and Research Committee. This was written into the constitution of the ASSC. Non-accountancy body members were however specifically excluded from membership at that time.

The First Reform

In 1970, the governing bodies of the professional accounting institutes had formed the Consultative Committee of Accounting Bodies (CCAB). In

⁴ This was not an isolated opinion. For other contemporary views see Robson, 1991.

⁵ The Scottish representation was soon increased to 3.

February of 1976, the ASSC was re-constituted as a committee of the CCAB and the word 'steering' was dropped from the title. The fundamental aims of the ASC were no different from that of the ASSC and did not alter throughout its lifetime. The change was the location of power, although domination of the ASC by ICAEW members was written into the new constitution, with 12 members (including the Chairman) nominated out of a total of 23, the remainder being divided between the other CCAB member bodies. The reliance on ICAEW committees was reduced to more of a consultation role, with the ASC forming its own working parties, although the constitution did allow it to obtain assistance to carry out its work from suitable organisations and persons without being specific as to the criteria for 'suitability'.

In 1978, the ASC set up a group under T R Watts to review the standard setting process and to consider possible improvements. This reflected the position of the ASC that it was time to seek the views of the public, and in a memo from the ASC to its members, the legitimacy of the Committee was of concern: '...it was necessary to seek an overt public mandate' (ASC 2/35/1). One of the problems was identified in an article by Lafferty (1979).

'You (Tom Watts) better than anyone must be aware of how much industry bias exists under the present set-up of ASC. Much as we would like to see each ASC member thinking only of users when he considers a proposed standard, the reality is that self-interest is bound to come through.'

(p. 50, brackets added)

In 1978, a draft consultative document was issued to form the basis for public discussion and comment. In response to this, there were 131 written submissions and public hearings took place in Dublin, Glasgow and London. The preliminary paper from Watts dated 10th March 1980 indicated that the majority of those consulted believed that accounting standards should continue to be set in the private sector, and due to the technical nature of such standards, the backbone of the standard setting body should be accountants, although the need for non-accountants to be members was accepted. The paper also suggested the need for a supervisory body to ensure compliance with accounting standards, and also urged that standard setters should be seen to act in the general public interest with its activities as open as possible. However, Watts concluded (somewhat reluctantly) that constitutional power should remain with the

Councils of the professional bodies, thus maintaining control of the process within the profession. A meeting of the ASC on 24th March 1980, decided that this interim report should remain confidential (ASC 2/35/1).

The final version (the Watts Report) was issued to the CCAB in 1981. This report concluded that accounting standards should be set in the open after public consideration and discussion, that membership should not be restricted to accountants and that a panel should be set up with the Stock Exchange to review non-compliance by listed companies. Additionally, it recommended that the standard setting body should be of high calibre and headed by a Director of Accounting Standards. Although many of its recommendations were not adopted until the formation of the Accounting Standards Board, some issues were reflected in the amended 1982 constitution which saw a shift from members in practice to members in industry, as well as reserving up to 5 out of 20 places for users who need not necessarily be members of any of the CCAB professional bodies. There was also the introduction of 'observer members' from academia and the government⁶. Links with the ICAEW were still strong. ASC secretariat staff who held wide responsibilities for the formulation of initial papers and the drafting of documents still remained part of the ICAEW Technical Directorate.

Although the membership of the Committee was widened over the life of the ASC, powers to issue standards in their own right were never held. The voting majority for members was increased in 1982 from two thirds to three quarters for the approval of any document and even then prior to issue, pronouncements had to be agreed by the Councils of all member bodies leading to further delays⁷ (see Chapter 7 for a specific example). Standards could be issued only by the professional accounting bodies themselves, which meant that enforcement was also effectively delegated⁸. Failure to observe standards rendered a member liable to disciplinary action from the appropriate accountancy body⁹, but the lack of strong

⁶ There had been an academic member since 1969.

⁷ The only exception to this being discussion papers (ASC 2/49/2)

⁸ The instigation behind this move came from the Scottish Institute who were reluctant to accept standards which were laid down by a sub-committee of the ICAEW, as the ASSC had been originally. See Slimmings (1981) p 18.

⁹ The explanatory forward to the Statements of Standard Accounting Practice issued in 1971 state that 'The Council expects members of the Institute...to observe accounting standards' and 'The Council through its Professional Standards Committee, may inquire into apparent failure by members of the Institute to observe accounting standards or to disclose departures therefrom'

action led to criticism of these bodies (Edwards, 1989), with Renshall (1992) noting that to his knowledge, no member was ever disciplined for breaching accounting standards during the lifetime of the ASC.

Although the ASC is credited with significantly changing British financial reporting practice (Renshall, 1992), it nevertheless was dogged by its various limitations. As well as having to serve (and satisfy) six masters on the CCAB, there was also the problem of the lack of formal consultation mechanism. Despite the setting up of a consultation group to advise on matters of the programme, proposals and work, this does not appear to have met since 1982¹⁰; following the Watts Report's recommendations for a wider membership it was felt that the consultation group no longer served a useful purpose (ASC 2/49/3). Shortcomings in the standard setting process were summarised in the Chairman's budget submission to the CCAB for 1986/1987 and were specifically identified as staff shortages causing slowness of action, lack of research, the phasing of projects and the inability to review standard avoidance (ASC 1/42/1). The Committee had proposed in 1987 to resurrect consultative panels (Financial Reporting Advisory Group and Panel of Academic Consultants) as well as seeking to undertake a review of communications¹¹. Both of these proposals appear not to have been proceeded with because of the Dearing Report (1988), although they may perhaps be seen as one reason for that report.

Furthermore, during its lifetime, the ASC had never been able to achieve power to enforce accounting standards. The Chairman of the ASC in 1978 summarised the situation which was to prevail for the next twelve years in a radio interview, '...we must be clear that we are a body which is setting a kind of law and the only way we can do that is by consent or persuasion' (T Watts)¹². In a meeting between the ASC and the Stock Exchange on 22.10.85, the Stock Exchange said they would not be inclined to suspend companies for non-compliance with a standard, and the only chance of enforcement would be through the law (ASC 1/81/1). In a meeting the following day with the Department of Trade and Industry (DTI), Godfrey (then Chairman of the ASC) stated 'The profession has limited powers of enforcement and the ASC itself had no such powers and did not seek them' (ASC 1/81/1). Much of the debate on non-compliance

¹⁰ See letter from D Wright, ASC secretary to E Gillott dated 27.3.90 (ASC 3/6/6).

¹¹ see memo from J Renshall, ASC Chairman to D Wright dated 1.1.88 (ASC 1/41/2).

¹² Interview on Radio 4 on 27.9.78 for 'The Financial World Tonight' (ASC 2/8/2).

was centred on Current Cost Accounting¹³. There exists evidence that at least on one occasion the ASC sought to have a form of legal backing to SSAP 16. In a letter to Godfrey dated 13th December 1985, Michael Howard of the DTI stated that '...the legislative approach is not one which the Government would be willing to take unless there were evidence of very much more support than there is at present' (ASC 1/81/1). However, by 1989, the DTI were prepared to include a requirement in the Companies Bill for directors to state whether the accounts were prepared in compliance with applicable accounting standards. In making this decision, they had no doubt considered the new structures for regulation, proposed by the Dearing Report.

The Dearing Report and the FRC

In November 1987, the CCAB had set up the Accounting Standards Review Committee under the Chairmanship of Sir Ron Dearing to review the accounting standard-setting process. Not only were resource and procedural deficiencies addressed, but also the absence of effective policing and enforcement of standards. In a letter, S Gray, the academic member of the ASC recognised this;

'While the ASC has achieved some progress I believe that its limitations have now become significant to the extent that major changes are warranted....what was needed was a change in the Companies Act which really confirms my point about the primacy of law.'

(Letter dated 8.7.87 to J Ould
with copy to J Renshall, ASC 1/38/2)

Later in the same letter he commented that the 'ASC should work more closely with the law' and that '...it seems to me unrealistic to believe that accountants have sufficient authority to significantly restrict or expand legal requirements'.

The Review Committee reported in 1988, making two main recommendations: a new non-statutory structure for setting and enforcing standards and proposals for changes in the law to encourage

¹³ The non-compliance rate was quoted by Godfrey as being 85%.

compliance with accounting standards. The question of the incorporation of standards into law was dismissed on the grounds that,

'..this inescapably requires a legalistic approach and a reduction in the ability of the financial community to respond quickly to new developments' (Dearing Report 10.2)

Ultimately, the recommendations were adopted and in 1990, the Financial Reporting Council was set up with its constituent Accounting Standards Board, Urgent Issues Task Force and Review Panel. Many of the perceived shortcomings of the previous regulatory system were addressed, in that as well as receiving increased funding and employing some full time members of the Board who operated independently of the accounting profession (detailed in Chapter 5), accounting Standards were issued by the ASB itself and the policing of those standards became a matter for the Review Panel.

THE SIGNIFICANCE OF ACCOUNTING REGULATION

Introduction

In the 1970's, following the setting up of accounting standard setting bodies in both the UK and the USA, the term 'economic consequences' became part of the accounting vocabulary¹⁴. Although such consequences had already been identified¹⁵, the particular term was not used. The rules of accounting found in previous Companies Acts in the UK, had doubtless produced such consequences. Although these were not perhaps explicitly discussed, they were nevertheless illustrated by the changing emphasis on shareholder and creditor protection contained within 19th century company law¹⁶. However, the separation of law and economic policy was thought possible in 1945 by the Cohen Committee which considered that it should concentrate on matters of law and that economic policy was outside their terms of reference (Bircher, 1989). The earlier absence of economic consequences could be a result of a less regulated environment,

¹⁴ The identification of economic consequences is attributed by Cooper & Sherer (1984) to the desire by large US corporations to counter attempts to increase levels of disclosure and change reporting systems.

¹⁵ See for example Zeff (1971) who considered that, 'More than ever was true in the 1940's or 1950's, accounting principles in the 1960's had entered the realm of public policy' p. 229.

¹⁶ See, for example Edey & Panitpakdi (1956).

since regulation usually creates some consequences (and it is this which often underlies the rationale for such an act). As Gellein (1978), a former member of the Financial Accounting Standards Board in the United States, points out 'standard setting would be purposeless if nothing resulted from the reporting' (p 75). If the results of accounting rules bring about economic changes then this will affect matters of efficiency and equity; therefore the regulation of accounting becomes a matter of interest to the society in which it operates.

The Impact of Regulation

One starting point for examining the impact of regulation would be to refer to the role of financial reporting in society. The role described by Gellein (1978) involves the 'allocation of available resources to those standing ready to furnish goods and services' (p 75). But, as he points out, reporting itself is not the allocator¹⁷, it is part of the structure whereby the allocation is made and therefore he suggests at an operational level, regulation should focus on decision-makers using the information rather than the consequences, a theme explored later in this thesis. This perspective is seen in various conceptual framework projects which have commenced with user needs (see for example The Corporate Report, 1975; ASB Statement of Principles, 1991, or the Statements of Financial Accounting Concepts in the US, 1978).

The direct impact of financial reporting may be seen in three main areas; the behaviour of management, the effect on the firm and the effect on society, although an inter-relationship exists between these areas as, for example, management may decide to act according to the effect on their firm or on society as a whole. Indeed the effect on the firm and the effect on society can in many instances be considered together. Bromwich (1985) describes only allocative and redistributive effects which in themselves could be as a result of the behaviour of managers to create such effects.

The behaviour of management as the information producer, has been recognised by Watts & Zimmerman (1978) and Cyert and Ijiri (1974), as a reaction to the effect on their own welfare. This type of impact on

¹⁷ Resources may for example be allocated through government policies of taxation or subsidisation, irrespective of what information is contained in financial statements.

management decisions has been termed 'information inductance' (Prakash & Rappaport, 1977; Selto & Neuman, 1981). Accounting reports may therefore influence the financing and operating decisions of firms (Heald, 1980; Butterworth Gibbins and King, 1981).

The effect on the firm has been described generally by Gellein (1978) as the impact on the enterprise cash flows because of actions taken by outside parties. Beaver (1981) describes this in terms of the competitive disadvantage of disclosure which could reduce the ability of a firm to reap the benefits of innovative activity. He uses a hypothetical example of a requirement to disclose a management forecast of earnings which might in some circumstances alter the nature of the investment projects undertaken, thereby affecting the risk-return trade-offs associated with the firm (although this latter example could also be used as an example of management behaviour).

The impact on society of financial reporting may be seen in terms of distributional issues. Solomons (1978) explains that changes in the status quo are effected because standards are set in controversial areas, a sentiment echoed by Cooper & Sherer (1984);

'...the outcomes of accounting policy are essentially political in that they operate for the benefit of some groups in society and to the detriment of others'. (p. 208)

The American Accounting Association had already recognised this in 1978, stating;

'Every policy choice represents a trade-off among differing individual preferences and possibly among alternative consequences'

Indeed May and Sunden (1976) justify the basis for the existence of a regulatory body by reference to the social welfare impact of accounting¹⁸.

Examples of Research into Economic Consequences

Much of the research into economic consequences quoted in this section has been based on work carried out in the United States. The reason for

¹⁸ Although Cooper & Sherer (1984) point out that the values and preferences of that body may not reflect society's preferences.

this may be the greater number of standards issued or may be a result of the larger amount of research carried out in the US, but nevertheless, at the very least it does illustrate the probable consequences of similar accounting standards in the UK. The following constitutes an illustrative cross-section of research into the impact of accounting regulations, commencing with the effect on the firm.

Marketable Securities-Statement of Financial Accounting Standard (SFAS) 12

By treating such securities in a different way from stocks, smaller and less frequent write-downs of such securities are necessary¹⁹. An adverse effect on earnings could be avoided by treating the entire portfolio as non-current and writing-down value losses against shareholder's equity thus making the earnings of investing firms less volatile (Daley & Tranter, 1990).

Foreign Exchange (SFAS 8)

Solomons (1978) described how the result of the standard was to increase greatly the volatility of reported earnings of companies with foreign operations by mandating the use of the temporal method.

Leasing

In the US, Ruland (1984) quotes examples of opponents of capitalisation claiming that this policy would depress ratios and therefore increase the cost of capital for US firms.

Goodwill

The requirement for US companies to write off purchased goodwill was said to give an advantage to foreign companies in bidding for US businesses (Daley & Tranter, 1990). This particular impact was also recognised in the UK and the standard on goodwill is explored in greater detail in a later chapter.

Deferred Tax - Statement of Standard Accounting Practice (SSAP) 11

The original UK standard advocated the full allocation method of accounting for deferred tax. Against a background of 100% capital

¹⁹ Under the standard, the calculation of lower of cost or net realisable value of marketable securities was based on an aggregate and not individual basis.

allowances, 30% inflation and stock appreciation relief, Hope & Briggs (1982), in the UK pointed out that companies would report reduced after tax profits because of the deferred tax charge, as well as disclosing very large deferred tax liabilities in the balance sheet²⁰. This standard was subsequently replaced by SSAP 15 which used the partial allocation method.

These types of research studies have often been criticised from a number of different viewpoints. Foster (1980) for example noted the inconsistency of Lev's (1979) research into SFAS 19 (Oil and Gas Exploration), claiming that this was indicative of the general failure of such tests to specify a theory of expected market effect. Taylor and Turley (1985) warn of the care that should be taken in interpreting the results of research, due to the difficulty of isolating a particular item of regulation from all other influences in the market. They also criticise the narrowness of such research, stating; 'Economic consequences will not stop at the boundary of the stock market, but will extend into other markets' (p. 117).

Studies of Management Decisions

Studies of management decisions are in many ways a subset of market-based research, in that a change in a management decision will have a market effect and the anticipated market effect will influence management decisions. Forcing managers for example to disclose that which they would rather not disclose could bring about sub-optimal decisions. For example, if a manager is forced to disclose environmental information, he may not undertake certain activities which might have maximised firms' profits. This could lead to a market effect whereby share price is reduced due to market perception of foregone opportunities.

Research and Development (SFAS 2)

The FASB (Financial Accounting Standards Board) was told by the respondents to its exposure draft that such a standard on research and development would discourage spending on research which would otherwise be in the best interests of the market (Gellein, 1978). Solomons (1978) claims that the standard was said to constitute a threat to

²⁰ Hope & Briggs quote the total liabilities in the manufacturing and distribution industries as increasing from £901m to £7,620m between 1971 and 1976.

technological progress especially in the case of new companies coming to the market, although Vigeland (1977) found no apparent market reaction to the standard. This was in marked contrast to the findings of Horowitz & Kolodny, 1980 and 1981, and Dukes et al (1980), that firms who previously capitalised research and development expenditure, significantly reduced such expenditure following the introduction of the standard.

Contingencies (SFAS 5)

The proposal to proscribe self-insurance reserves on grounds that the need for insurance would exceed the capacity of US insurance market, meant that overseas insurers would have to be used, thus impacting upon the US balance of payments (Gellein, 1978; Solomons, 1978).

Foreign Exchange (SFAS 8)

In order to mitigate the effect of this standard, it has been reported that additional currency hedging was used to minimise such fluctuations (Griffin, 1979). Investment and financing decisions by US companies are also felt to have been affected (Evans et al, 1978; Shank et al, 1980).

Oil and Gas Exploration (SFAS 19)

This standard was over-ruled by the Securities and Exchange Commission on the grounds that exploration activity could reduce if the basis of accounting were changed to 'successful efforts'.

Troubled Debt Restructuring (SFAS 15)

This standard avoided banks having to write-down debts when they had been restructured. Daley & Tranter (1990) describe this treatment having been adopted because of the possible effect on reduction of capacity and the willingness of banks to lend.

Leasing (SSAP 21)

Taylor and Turley (1986) describe the UK effect in terms of the direct consequences of a reduction in investment²¹, as well as the indirect effect e.g. changes in cost, thus altering the investment and financing decisions of managers. In the US, the capitalisation of finance leases has also been the subject of research which suggests that managers will try to re-

²¹ A sentiment also echoed by the DTI in their reply to the Exposure Draft on leasing.

structure leases in such a way as not to qualify as finance leases (Abdel-Khalik 1981)²².

Lobbying and Regulation

Even in the absence of market-based or other empirical tests of economic consequences, the presence of such consequences, potential or real may be evidenced through the actions of those parties interacting with accounting information either as a producer or user. Ruland (1984) describes the economic consequences approach existing;

'...implicitly by parties lobbying for or against standards which will affect their welfare' (p. 224)

Lobbying is described by Sutton (1984) as the taking of an action to influence a rule-making body. Such actions are examined in detail in later chapters in the context of the development of two UK standards.

Direct lobbying of the standard setting body could either be by government, governmental agency, by industry (including professional bodies) or by any other information user. In the first instance it is sometimes difficult to discover whether the government instigates its own actions in lobbying or is merely passing on pressures exerted on it from outside. Solomons (1986) and Daley & Tranter (1990) quote the example of the Accounting Principles Board in the US being overturned by both the SEC (Securities and Exchange Commission) and Congress on the issue of accounting for investment tax credits. FASB received similar pressure from the SEC over their attempted standardisation of oil and gas accounting in FAS 19 (Solomons 1986), following the anti-trust division of the Department of Justice testifying to the SEC on this standard (Beaver 1981 p 50). Solomons (1981) considered that the origin of this action was outside of government;

'...the Securities and Exchange Commission would not have acted... to over-rule this standard if there had not been political pressure from certain oil and gas companies' (p. 68)

In the case of troubled debt re-structuring, FAS 15, it was the Comptroller of the Currency who lobbied the SEC (Daley & Tranter, 1990), although they also quote examples of the SEC being lobbied by industry on the same

²² Perhaps this fear was ill-founded in view of the later research on gearing levels and bond premiums, see Wilkins & Zimmer (1983).

issue. Additionally, Daley & Tranter (1990) in the case of the original exposure draft on marketable securities describe the insurance industry as lobbying the SEC.

There are also UK examples of direct governmental intervention in the process of regulation. According to Solomons (1986) the Sandilands Committee was set up to circumvent the Constant Purchasing Power Standard (PSSAP 7), because of the proposed use of indexation in the standard. Indeed in the terms of reference, the Sandilands Committee was told to take into account the need to restrain inflation, although suggestions have been made that it was also an intention to re-distribute wealth from workers to shareholders. (See Cooper & Sherer, 1984). Other examples of the UK government acting as a pressure group with regard to accounting regulators are examined in Chapters 7 and 8.

Although governments both in the UK and the US appear to have effectively over-ruled accounting regulators on occasions, industry lobbies do also appear to be successful where some standards are concerned (two of which are looked at in detail in a later chapter). Hope and Briggs (1982) state that the first standard on deferred tax (SSAP 11) was effectively withdrawn in the face of industrial opposition. Widespread refusal to comply with SSAP 16 (Current Cost Accounting) was a contributory factor to its demise. Evidence of lobbying can be seen in the replies to Exposure Drafts both in the UK and the US, and although this is often the only visible evidence of lobbying, it must be noted that there are many other stages at which it may take place (Lindahl, 1987; Sutton, 1984).

Accounting Regulation - Political or Technical?

Horngren (1973) is not alone in believing:

'The setting of accounting standards is as much a process of political action as of flawless logic or empirical findings' (p. 61)

The process tends to be political because the outcomes of standards is re-distributive and affects the welfare of groups in society (Bromwich, 1985). At the same time he (Bromwich) claims that there is little evidence that Pareto solutions exists. In that case, not only are those who might benefit from regulations inclined to influence the outcome, but also those who

might lose. The welfare issue tends to be centred around different user groups²³ and in the absence of optimal accounting policies, regulators have

'...a political role of trading off conflicting objectives of financial statement user groups' (Cushing 1977 p. 311)

Solomons (1978) in emphasising the behavioural view of accounting regulation, points out that accounting is not unique in affecting behaviour, using paradigms from physics, geology and medical research to illustrate behavioural effects. Hawkins (1978) considers that FASB, because it has the power to influence economic behaviour, also has the obligation to support (government) economic plans. Thus he takes the somewhat radical view that macro-economic objectives should be paramount in determining accounting standards²⁴. Other writers such as Rappaport (1977) advocate a perspective broader than pure technical considerations, while Buckley (1976) criticises US standard setters for only using theoretical arguments and being oblivious to social impact. Once this view is adopted, the regulatory process must become intentionally political. This is defended by Gerboth (1973) on the grounds that politicisation of accounting is a necessary part of the democratic legitimisation of authority. The FAF (Financial Accounting Foundation), the organisation overseeing the work of the FASB, appears to have accepted this argument, through their admission that standard setting requires some perspective and that the regulators are representatives of the entire constituency of users, implying a political process. This 'representative' role is however somewhat difficult to reconcile with the fact that no set of standards exist which are able to rank alternatives in accordance with preferences and beliefs (see Demski, 1973; Arrow, 1963).

The tentative (and perhaps optimistic) solution to this is suggested by Cooper & Sherer (1984) ;

²³ Recent conceptual framework projects have tended to emphasise the investor user group justifying this choice 'As investors are providers of risk capital to the enterprise, the provision of financial information that meets their needs, will also meet most of the needs of other users that financial statements can satisfy', (Para 10, Accounting Standards Board, Exposure Draft, Statement of Principles).

²⁴ The result of such a view would appear to place accounting regulation within the responsibilities of government, but Hawkins is not explicit in this area.

'It is necessary to make explicit a social welfare function which enables trade-offs to be made between individuals and society'

(p. 214)

While this assumes that such a function could be disclosed, it may also be said to involve some compensation principle where a Pareto solution cannot exist. Both the acceptance of a social welfare function and any ensuing compensation are however, political acts²⁵.

Accounting as Public Policy

It would appear from the research carried out into economic consequences that these do exist and therefore that accounting regulation like any other political actions has an effect on the community in which it is carried out. The arguments used in regulation may be technical, but the results involve changes in welfare and are therefore political. The process whereby standards are set imitate parts of a political process whereby the regulators are lobbied by those having an interest in the area under discussion. The objective of accounting should be neutral according to Solomons (1978) who considers that the intention to achieve anything other than 'pure measurement ends', would 'destroy faith in accounting' (p 69). Ruland (1984) looking at accounting regulation from the viewpoint of ethical philosophical thought and in terms of deontology and teleology, concludes that the former through the pursuit of representational faithfulness²⁶ should guide the regulators and describes FASB's conceptual framework project as an 'effort to operationalise the representational faithfulness approach' (p 224).

Representational faithfulness however, in a way reminiscent of Solomons' (1978) 'financial map-making', is not universally accepted and appears to be at odds with the social welfare view of accounting. Cushing (1977), describes optimal accounting principles as those whereby users achieve an expected payoff which is greater than or at least equal to the corresponding payoff under an alternative principle. There is implicit in

²⁵ If, for example, the interests of the equity investors are exclusively satisfied, this may involve a wealth transfer from labour to capital. If however subsequent legislation is passed which guarantees minimum wages or shorter hours, this could represent the re-distribution.

²⁶ This qualitative characteristic is subsidiary quality of reliability in SFAC 2. Nobes & Parker (1995) give as a definition that 'accounting information should represent what it purports to represent: in other words, it should be true.' p. 156.

such a statement that the objective of regulation is to seek Pareto optimal solutions. This changes the role of accounting to one of social policy rather than pure description. Beaver (1981) adds to this by talking of the relative importance which should be assigned to the preferences of each user group. Any ensuing welfare decisions may not necessarily be made by the regulators themselves but from other sources as Ruland (1984) suggests;

'...if one refrains from acting for the welfare of others, it is not at all certain that their welfare will not be attended to by other means
(p. 233)

This is reminiscent of the Carsberg, Arnold and Hope (1977) suggestion of choice between accounting alternatives becoming part of a democratic political process.

This leads to two possible approaches to accounting regulation. Firstly the neutral and secondly the pre-determined social welfare/national goals approach. If the former approach is adopted by the regulators, then on a standard by standard basis they will be lobbied by those seeking to increase their own welfare as there is no universal acceptance of the interpretation of neutrality. If the latter approach is taken, then again those seeking to maximise their own welfare will attempt to change the social welfare objective of the regulators. Under both circumstances, the process of regulation is in the political arena and the regulators must attempt to insulate themselves from such influence if they are to act independently.

THE CONSTITUTIONAL ENVIRONMENT

Accounting regulation however is only one part of the broader context of the general system of rules affecting society. The framework for such rule-making is a constitution, defined by Graham and Prosser (1988) as follows;

'A constitution, written or unwritten, outlines the basic structure of the state, the relative powers of the organs and lays down particular principles for the action of public bodies, for example the due process clause in the US constitution.'
(p. 4)

Writing in the nineteenth century, Dicey (ed. Wade, 1959) considered that there were two fundamental constitutional principles; the legal

sovereignty of Parliament and the Rule or Supremacy of law. Bradley (1985) describes the legal sovereignty of Parliament as a doctrine of constitutional law which means that there are no legally enforceable limits to the legislative authority of the Parliament. The fact that the courts are able only to review the administration rather than the validity of legislation implies that such power is absolute. Dicey stated that the legislature has 'the right to make or unmake any law whatsoever' and that no body or person outside of the legislature 'is recognised by the law of England as having a right to override or set aside the legislation of Parliament' (p. 40).

Liberal Democratic Principles

The 'Westminster' system is described by Oliver (1991) as an expression of the liberal-democratic political tradition, under which the exercise of state power is justified in terms of the public interest rather than of the interest of one class or group²⁷. The tradition dates back to the 17th century where the term 'common good' (Locke), 'general interest' (Mill) and 'general will' (Rousseau) are all expressions used to describe approximately the same ideas as the public interest. Finer (1970) outlines six basic assumptions for the liberal-democratic state. The first of these is that government is derived from public opinion and is accountable to it. Accountability implies an ongoing test of the representativeness of government: it is not sufficient for power to have been granted in the past based on public opinion at that time. The second of these assumptions concerns the expression of public opinion which implies some kind of suffrage carried out through a system of representatives. The third assumption is that in matters of contention, it is the majority will that should prevail. The remaining assumptions tend to qualify rather than compliment characteristics of democracy. The first of these is that government is limited in that certain rights of the individual and of the private association are safeguarded. Additionally, society is recognised as being pluralistic, hence the rule of government is not confined to any one group, but should operate in the common interest, putting on government the rather onerous task of reconciling different viewpoints. The final qualification concerns the denial of any objective science of society or of morals and again serves the purpose of limiting power through the admission of tolerance based partly on the premise that

²⁷ Although Oliver (1991) notes increasing criticism of the system over the last decade in terms of public disillusionment in matters of prosperity and the distribution of wealth.

views as to what is true and proper for government to act upon will change over time²⁸.

The Sovereignty of Parliament

The sovereignty of Parliament is described by Jowell (1985) as being one of the major premises upon which democratic theory rests. Bradley (1985) states that even the right to make constitutional changes by ordinary processes of legislation is in their powers. This sovereignty is built upon the legitimacy of parliament to act and is the process by which authority is given to those who wield power (Halsey, 1986). Legitimacy is given to the legislative process because of the system of elected representatives (Bradley, 1985). Although authority can be derived from tradition²⁹, modern societies see that universal and unconstrained acceptance is a necessary condition for legitimisation (for example see Rousseau). Although obedience to the state was traditionally viewed as being based on habit and custom (see Moore, Johnson, Marx), social contract theories rested more on the idea of obedience being based on the consent of the governed³⁰. Bentham considered that the majority opinion represented the greatest sum of happiness. An alternative view of authority is given by Finer (1970) who considers that the exercise of power is acceptable because its advocates are regarded as the wisest, the best or the most representative or because '...it appears conducive to happiness or welfare or greatness or whatever other value has an over-riding value' (p. 15). This echoes both Bentham who believed that majority opinion represented the greatest sum of happiness and Burke in his description of the State as holding 'the accumulated wisdom of generations', although Finer's (1970) acceptability of power does reflect changes in society over time.

Authority does not however necessarily achieve these objectives. Halsey (1986), while acknowledging that general rules may be based on the preferences of the majority, points out that bureaucrats may easily and frequently 'break the chain from popular will to executive decision'

²⁸ Reminiscent perhaps of Counsel's opinion on the meaning of True and Fair.

²⁹ For example the dynastic legitimacy of absolute monarchy which Cranston (1966) describes as the Divine Right of Kings, a widely accepted belief throughout Europe in the 17th century.

³⁰ Social contract theories have ranged from the Hobbesian absolute power of the sovereign to the limitation of such power by the natural rights of the individual (Locke), this latter version being more in line with liberal democratic theory.

(p.159), implying perhaps that wide discretion, at times verging on policy decisions is exercised by bureaucrats³¹. A second limitation Halsey identifies is in the area of personal authority, where decisions are accepted on the basis of a kind of charisma (which was one of Weber's (1947) types of legitimate authority), whereby the inspired leader is absolved of having to justify the decision in terms of theory, fact or value³².

The election of representatives of the people to Parliament is the way in which legitimacy is given to the legislative process (Bradley, 1985). The process is one which encompasses notions of consent and 'responsibility', a further feature of liberal democratic governments implying the concepts of 'responsiveness, good conduct and accountability' (Dunleavy and O'Leary, 1987). The grant of authority to Parliament is given partly in recognition of the sovereignty of that body as the locus of rule-making. Where other bodies are involved in rule-making, formal authority may not been vested in them directly by the people. Additionally, there may be no way in which subsequent accountability can take place.

Power Outside the State

The tradition of rule-making outside of Parliament in the UK dates back to the 18th century with the creation of certain non-governmental agencies. The constitutional awkwardness of having power exercised outside of central government has long been recognised on both sides of the Atlantic. Graham and Prosser (1988) consider that changes in the structure of the state to create public agencies have, in the UK, in contrast to France and the United States raised little debate. This is endorsed by Lewis (1985) who talks in terms of the 'disintegration of the model of representative and responsible government' (p. 199) because of the way the British state operates 'increasingly not through a framework of public rules, but through administrative processes in which it seeks to achieve particular goals through the discretionary use of power'. Graham & Prosser (1988) describe how;

'Instead of being exercised through institutions of central and local government conventionally subject to democratic forms of accountability, an imposing edifice of quasi-government has

³¹ Additionally, Smith & Hague (1971) quotes public concern that a unified civil service acting under a minister is an impediment to public accountability because of secrecy and lack of public access to the bureaucracy.

³² Examples of this are quoted by Crossman (1976), on becoming a minister.

been erected posing new problems of accountability and control'
(p. 8)

Courts have adopted the language of 'private' and 'public' law without addressing the new constitutional problems raised by the former, at times disclaiming administrative law jurisdiction over both 'quasi' and 'quasi non-government' bodies (Harden, 1988).

The Pliatzky Report³³ (1980) referred to fringe bodies which are 'not a Government Department or part of a Government Department' but which have 'executive, administrative and regulatory functions'. These fringe bodies are not only numerically significant, (with a 1979 estimate by Holland and Fallon putting their numbers at 3000), but have been a long-standing feature of the UK with some of the earliest examples being the Poor Law Boards of the nineteenth century³⁴. It was recognised that power exercised outside government did not accord with the traditional view of the liberal democratic state. Sir Ivor Jennings writing in the 1930's described prosaically how;

'..twenty four ministers are not leaders of columns that march behind them in regular ranks, for the columns now have outriders on their flanks and a relatively unorganised mass of camp followers trailing behind...Equally false is it to assume that for every act that is done by a public authority, someone is responsible to Parliament'
(p. 80)

This was also recognised in the USA where the President's Committee on Administrative Management set up in 1937, described regulatory agencies as the 'headless fourth branch of government'.

These changes to traditional administration have been brought about in many instances by the search for economic efficiency, which tends to have over-ridden other considerations. The growth in state intervention in the economy in the twentieth century has taken place against a background of constitutional thought which assumed that the state carried out few functions (Graham & Prosser, 1988), and therefore the constitutional

³³ This was a government report into 'types of body which have a role in the process of government in the UK, but which are not Government Departments or part of a Government Department' (p. 1).

³⁴ For a historical view of agencies, see Baldwin & McCrudden (1987) Chapter 1.

implications of this growth appear not to have been considered³⁵. Moran (1988) describes how these economic changes 'implied important alterations in key constitutional practices.....in the way the line was drawn separating public from private power' (p. 56). Recent commitments to limited state intervention in industry does not signify the solution to this problem but has merely brought about a shift of power to non-government organisations.

'Policies have been pursued which have been designed to encourage, directly and indirectly, the emergence of organisations willing and able to co-operate with government in its approach to social and economic problems and to assume delegated responsibilities accordingly' (Harden, 1988, pp. 42/43)

Examples of such organisations are the Securities and Investments Board (SIB) and the Self Regulatory Organisations (SRO's) with powers delegated by the Board. Such structures tend to operate within a corporatist framework which is defined by Shmitter (1979) as;

A system of interest representation in which the constituent units are ... recognised or licensed (if not created) by the state and granted a deliberate representational monopoly.....in exchange for observing certain controls on their selection of leaders and articulation of demands and supports.' (p. 13)

Corporatism is viewed by Middlemass (1979) as a form of continuous contract in which power is shared between the state and large organised groups³⁶, with Harden (1988), arguing that corporatism has been the traditional basis for the operation of City institutions.

'The reshaping of the City has not diminished the importance of corporatism in its structure, albeit there has been a change in the nature of self-regulation and the forms of state involvement in the regulatory process.' (p. 50)

He talks of these institutions as now being 'more visibly clothed with the power of the state'. Moran (1988) also describes how the established system

³⁵ This is not a recent development. The central constitutional problem of regularising relations between nationalised industries and government was given too little thought, with other matters dominating the thinking on these industries. (Graham & Prosser, 1988)

³⁶ Although Birch (1985) felt that corporatism has not really occurred in the UK, and quotes the fate of the NEDC's and the Social Contract as examples.

of regulation in the City was corporatist. Institutions which he described as 'semi-private' such as the Stock Exchange carried out 'representation and regulation' The system under which the City operated meant that;

'..entry to markets was closely controlled, with admission depending on willingness to observe severe limits on competition; authority was exercised with a maximum of discretion and a minimum of precise rules, especially of rules derived from statute; and the whole system was guided and protected by the City's Guardian Angel, the Bank of England.' (p. 58)

This situation termed by Harden & Lewis (1983) 'a delegation of public functions to private control', decayed because of what Moran (1988) described as 'a combination of scandal, economic crisis and market innovation' (p. 58). He outlines how, by the beginning of the 1980's these arrangements were clearly not working, and yet the surprising response of the government was to make such a corporatist system stronger through the Financial Services Act of 1986, which he describes as an attempt to appropriate the power and legitimacy of the democratic state to support corporatist arrangements. Gower (1985) remarks that '...the Securities and Investment Board is envisaged as being a private, practitioner-based body.... exercising public functions and statutory powers.' (p. 12). The original SIB and its subordinate SRO's were able to exercise a monopoly of regulatory powers over their constituents and are therefore claimed by Moran (1988 p. 59) to be an example of a system which is exactly in accordance with Shmitter's (1979) definition of corporatist representation.

Baldwin & McCrudden (1987) recognise a further problem associated with the use of agencies, in that they can be '....constitutionally awkward in that they combine powers that have traditionally been kept separate' (p. 3). The powers to which they refer are the legislative, administrative and judicial powers. Although the ASC may have been termed legislative (but with no powers of enforcement), certainly the post 1990 structure for accounting regulation contains in the Review Panel, investigative powers which would imply an administrative if not a quasi-judicial function.

Within this array of non-governmental agencies, private sector accounting regulatory bodies have existed since 1970. Situated among agencies which have been described as 'constitutional anomalies' could

imply that the accounting regulators, promulgating a kind of law³⁷, were in a somewhat tenuous situation, and there have always been concerns that the government would take over their functions. Nevertheless the ASB would now appear to be firmly established as the agency holding an almost delegated authority to issue accounting rules, through the recognition of their status and pronouncements in the Companies Act.

SUMMARY

This chapter describes how private sector accounting regulation in the UK started from the ICAEW and gradually incorporated the other professional accounting bodies. Although reviews of the standard setting process introduced a wider input to regulation, the institutional and operational problems meant that a fundamental change occurred in 1990 with the setting up of the FRC and its constituent companies. Accounting regulation has been shown to have economic consequences which may affect both the behaviour of managers and the actions of those stakeholders who use accounting information for decision-making. These regulations have been described as a kind of law, but one which is set in the private sector rather than by government. As such, accounting regulators join a growing band of agencies whose constitutional position is unclear, but whose presence, government not only tolerates, but would appear to encourage. This theme is explored in later chapters.

³⁷ See earlier quote from Watts.

CHAPTER 2

AGENCY CLASSIFICATIONS AND CHARACTERISTICS

INTRODUCTION

Chapter 1 outlined certain of the constitutional problems concerned with power being exercised outside of Parliament. In this chapter, it is the institutional structure behind that power which is being examined in the context of regulation, described by Kells (1992) as a process whereby;

'...a system, institution, program or procedure is attuned over time to expectations (intentions, standards, norms) through choices and actions judged by the regulators to be needed as a result of formative or summative evaluation' (p. 17)

Regulatory actions imply a response to a changing environment and interaction with the originators of the expectations. The choices and actions of the regulators would not appear capable of satisfying these societal expectations, unless the institution carrying out the process is structured in such a way as to allow formative and summative evaluations to be made. The purpose of regulation is generally equated with promoting the public interest¹ (Lemak, 1985; Stigler, 1971; Noll, 1971). If this is the case, the regulatory body should therefore act in accordance with this mandate whether implicitly or explicitly expressed. Although there exists more than one version of the public interest, it would appear that a pre-requisite for any of these versions is that the agency concerned should act in an independent manner defining such a term as 'freedom from control' or 'possessing autonomy' (Chambers, 1993; Collins, 1979).

Whether or not the agency can be described as independent, must depend upon both the internal characteristics and external environment of the agency. The identification of the key characteristics which could influence the judgement of the regulators, is a prerequisite to assessing the performance of a regulatory body as well as the development of a model which may predict whether regulatory pronouncements are made in the

¹ Chapter 4 examines public interest in the context of accounting regulation.

general interest or whether some form of 'capture' or undue influence will occur. This chapter examines those characteristics of agencies which may affect (either positively or negatively), their independence. Additionally, it places accounting regulators under the broad definitions of agencies .

DEFINITIONS

One of the initial problems encountered in attempting to study agencies is one of identification and definition. Within the field of political science, the term is applied to organisations described variously as quangos, commissions, boards, committees, bureaux and statutory authorities, with some writers also applying the term agency to those government departments which have similar characteristics (Burch & Wood, 1986; Dunleavy 1991). The Oxford English Dictionary (1982) defines agencies both in terms of institutions i.e. having 'concrete existence', an 'establishment', as well as in terms of actions i.e. 'working as a means to an end'.

Other agency definitions tend to be found mainly within dictionaries of public administration which stress their carrying out of a governmental type of function while remaining independent² of any branch of government (Shafritz, 1985; Chandler & Plano, 1988). The term 'Bureau' tends to be used mainly in the US whilst more generally the terms 'Board' or 'Commission' are often used interchangeably with 'Agency', although 'Board' may be differentiated by being applied to a group that exercises policy or decision-making functions, whereas 'Commissions' are often assigned regulatory responsibility (Chandler & Plano, 1985). Where the word committee is used, it is usually defined as a sub-group of a larger body formed for convenience to look at matters of detail which implies that this delegation of responsibility prevents the making of binding decisions (Robertson, 1985). The committee therefore can only make recommendations to the main body or report conclusions³.

² The definition of independence on the previous page, encompassing freedom from control is particularly relevant in this context.

³ The lack of direct powers in this definition can be seen to apply to the ASC.

Certain agencies have been termed 'quangos', which are described by Stoker (1990) as '...organisations that involve voluntary and private enterprise resources but which nevertheless receive public funding and undertake tasks crucial to public policy' (p. 127), but Self (1985) criticises the word quango as being misleading and expresses a preference for the terms 'government regulated or sponsored agencies' and 'hived off or semi-independent public agencies', whereas current terminology also includes 'non-departmental public bodies' (Thompson, 1993). What is common among the definitions is the fact that public policy or public business is being carried out by a non-governmental department and it is perhaps this function that is more important than the descriptive label attached to the organisation carrying it out. Chapter 1 examined the constitutional problems associated with such actions and why the regulation of accounting might be considered an act of public policy.

CLASSIFICATIONS AND CHARACTERISTICS

Quite apart from the problem of definition or description, agencies do not appear to be capable of being placed into discrete categories which capture all of their characteristics. Hanson & Walles (1978) recognise the difficulties in providing either a functional or typological classification of agencies. They see the reasons for such difficulties as arising from the various ways in which agencies are constituted and their heterogeneity of purpose, a sentiment also expressed by Self (1977). Where attempts at agency classification have been made, they have tended to be one dimensional, not reflecting all the organisational and functional complexities. Self (1985) for example produced a classification based on the motives for agency creation (which is examined in detail in Chapter 3). This would not necessarily reflect or represent a classification made for example the basis of either agency power, purpose or constitution. Agency functions formed the basis for the Pliatzky (1980) classification but certain of the functions he described e.g. advisory and executive, could be found within the same body. Thompson (1993) classifies what he terms as 'quasi-governmental bodies', by way of legal forms of creation. These include creation by statute, by Treasury minute and registration as a company.

In the absence of a single satisfactory way of classifying agencies due to the complex and heterogeneous nature of such organisations, most writers

have tended to analyse agencies through sets of characteristics or conditions (Hanson & Waller, 1978; Jennings, 1930; Wilson, 1980; Smith, 1972; Dunleavy, 1991). This does not necessarily produce simply a disparate number of characteristics⁴. A review of the literature both from the UK and USA, indicates that these characteristics may be classified into three main areas: a) motives for agency creation; b) agency tasks and c) agency structure and operations. These areas encompass the conditions which Self (1977) considered necessary to maximise the independence of agencies. Self's four conditions were, 1) abnegation of government control, 2) dealing with tasks which can be isolated from the rest of government, 3) existence of an adequate and independent source of revenue and 4) the absence of a powerful interest group of clients who substitute theirs for government control.

Any attempt at examining the independence of agencies under the structure outlined will thus include Self's (1977) maximising conditions. The motives for creation is significant in that an agency may have been formed by government deliberately to shift a function from the political arena. Alternatively, an agency may have been created by the private sector in order to prevent government interference, yet exists with the tacit consent of government as the ultimate holders of state power. The tasks of an agency may define the degree of independence it enjoys. A function that is seen as non-political would be free from government interference (although possibly not from the actors in the societal area in which it operates). The structure and operations of an agency include its funding, personnel, procedures, constitution and clientele, each of which can impact significantly its' decisions and therefore on its' independence.

⁴ One of the most comprehensive attempts in this area was made by Phillip Holland, a Member of Parliament who in 1979, recognised 947 different types of agencies using several variables, although his motive for this work was to reflect (and condemn) the then contemporary proliferation of agencies (Holland & Fallon 1979).

Motives For Agency Creation

Baldwin & McCrudden (1987) provide a brief history of the reasons for agency creation, and describe how the earliest examples of UK agencies carried out functions considered at the time to be non-political. Agencies such as the Poor Law Commission at the beginning of the eighteenth century were independent from direct parliamentary supervision and were characterised by being controlled by Commissioners whose independence was enhanced by having responsibility for their own budgets⁵. Such a structure as this was intended to create a strong and fearless administration, but became subject to intense political pressures because of its lack of accountability to (and sponsorship from) government. Ultimately, as they grew in size and functions, such agencies were either assimilated into existing ministries or became Departments of State in their own right (Smith, 1972)⁶. The history of agencies are described by Baldwin & McCrudden (1987) in almost cyclical terms, arising during the period of evolution of government and declining with the growth of central government from 1830 to the end of the century. Although several new agencies were created by the Liberal government of 1906, concern was increasing during the early part of the twentieth century with the growing power of central government, especially after the first world war. Such concerns were first articulated by the syndicalists and the Fabian socialists (Smith, 1972), and had increased by the end of the second world war⁷. However during this period of growth in State power, the 1930's had seen the setting up of quasi-regulatory marketing boards, and the 1940's had seen wide scale nationalisations (see Hannah, 1983). These actions did not involve the transfer from the State of existing powers and responsibilities, but nevertheless established the principle of powerful non-governmental or private sector bodies.

Agency creation received a boost from the Fulton Committee in 1967 which encouraged the use of agencies in a broad role in society. However

⁵ The income arose from a parish levy on all occupiers of property (Rose M , 1971).

⁶ The Poor Law Commission being abolished in 1847 and was replaced by the Poor Law Board, whose President was a member of the Government, thus bringing the poor law into the sphere of political control.

⁷ The publication of Hayek's 'Road to Serfdom' in 1944 reflected these concerns.

this committee was in many ways only reflecting the creation of a plethora of agencies in the 1960's which continued through to the 1970's. These agencies covered both social life and industrial activity, partly in order to create a continuous form of control rather than spasmodic tinkering with matters, as well as being the result of a move towards a more pluralistic approach to public policy.⁸ New attitudes and a different approach to public policy were illustrated by the incoming Labour government of 1964 in the setting up of the Department of Economic Affairs. This significant new Department required a host of planning and regulatory agencies to work alongside it, among which were the Prices and Incomes Board (1965) and the Industrial Re-organisation Corporation (1966). Agency creation did not stop with the change in government in 1970. Baldwin & McCrudden (1987) explain this in terms of social changes;

' Although the notion of the managed economy had waned by the start of the seventies and the cult of economic liberalism had become stronger, the momentum of corporatism was sustained. The new aim was to make tripartism work - if not for the purposes of general planning, then in specific areas' (p. 21)

The devolution of government powers whether in the interest of increasing pluralism or whether for some other motive, may be seen as a major factor behind the creation of agencies. A government intent on reducing State power might try to do so by setting up alternative bodies⁹.

⁸ Dunleavy and O'Leary (1987) describe institutional pluralism as an antidote to uncontrolled State power although they admit that 'Pluralistic approaches to.....policy making still dominate the political science literature of Western Europe and North America, although much less than in the 1960's' (p 70).

⁹ The functionalist view of the State in its ex-ante approach defines the State as 'that set of institutions which carries out particular goals, purposes or objectives' (Dunleavy & O'Leary, 1987 p 3). Under such a definition therefore, a private sector accounting regulatory body would be seen as part of the State. Since the emphasis of this chapter is on the characteristics affecting the independence of agencies (from governments as well as those being regulated), this functionalist view of the State will not be used further.

Hood (in Baldwin & McCrudden 1987), notes that agencies could be used by government in creating space for a new policy within the machinery of government or concealing the real size of the bureaucracy. His idea could be extended to the use of agencies to re-inforce existing policy. The arguments against 'big government' both in the US and UK have arisen in response to the growth in government which Self (1985) attributes to changes in the technological, economic and social environments. The creation of agencies could be seen as a way of rolling back the frontiers of the state. This may appear to be at odds with moving towards a stronger and more centralised state, but in the case of the UK, Dunleavy (1991) reconciles this apparent paradox by describing the move by the Thatcher government;

'away from the conventional integrated ministry structures, and towards a Swedish-style distinction between core policy-making ministries and hived-off executive agencies' (p. 225)

Smith (1972) attributes the development of regulatory agencies in the US to fear of direct government intervention in the economy. Noll (1971) also expresses similar sentiments in describing a pervasive view that regulatory agencies protected society by positioning themselves between unscrupulous businessmen and corrupt politicians. The US has a traditional fear of tyranny, and any sharing of powers therefore should make it difficult for the government to either be captured by interest groups or dominate society (Wilson, 1980). The objections however to 'big government' are not necessarily based on fear or ideology but may be pragmatic. The overload thesis of Rose (1985) argues that as governments take responsibility for solving more problems, then the weight on political and administrative machinery grows. If more regulation is forthcoming, then popular compliance decreases and bureaucracy becomes disliked (as well as becoming more expensive to operate). The overload argument is also espoused by the managerialist school (Slatter, 1982) and gives as its solution, the hiving-off of more routine tasks to semi-autonomous agencies. Not only does this provide a repository for routine functions, but also serves the purpose of helping to create expert bodies. Efficiency gains may be made by moving away from the amateur and generalist approach of the civil service, towards more expertise and scientific management (Smith, 1972). This theme of specialisation and expertise is

expanded upon by Hanson & Walles (1975) who accentuated the need for the;

'...use of administrative and managerial techniques allegedly difficult for the officials of a normal government department to acquire and apply' (p. 194)

giving as their main reasons for such difficulties, civil service status, subjection to Treasury control and answerability to Parliament. Baldwin & McCrudden (1987) also recognise the benefits of the use of expertise within a rule-making or adjudicative body whose actions are inappropriate for a government department or a court. They further argue that within such bodies, independence from government needs to be shown just in order to apply such (neutral) expertise. An agency might just as well be used rather than an expert court because of the potential volume of decisions as well as the ability to be free from technicalities of procedure. Their specific justifications for the use of agencies encompass both the expertise and the 'big government' rationales as well as operational factors, and are as follows;

- 1) ability to involve the public in decision-making possibly through the use of appointments to incorporate interest groups, which, due to operating conventions, may not be possible in the case of government departments.
- 2) giving the appearance that the government is doing something about a matter. A government can always claim that an expert body is investigating or acting on a particular matter.
- 3) where administration of a particular policy is viewed as being politically dangerous with few obvious political benefits to the government.
- 4) lobbying and requests for political favours may be deflected from the government to a body which will evaluate their arguments on a technical basis
- 5) avoids awkward or burdensome duties being added to existing tasks of departments or courts.
- 6) if a certain matter is the sole responsibility of one agency, it will be better administered. Through the build-up of expertise, the better administration will follow automatically; such expertise could be either technical or procedural.
- 7) division of labour helps with specialisation and expertise.

- 8) speed of decisions and freedom from technicalities are an advantage over the court system.
- 9) agencies are not restricted to formulating policy on a case by case basis as are the Courts.
- 10) fine tuning of rules can be made without involving the legislature. This in turn prevents delay in re-acting to situations.
- 11) an agency may be a mechanism which raises and clarifies arguments upon which political decisions depend. Public opinion is focused and issues are introduced that enrich political debate.

However wide ranging and appealing these arguments, the 'constitutional awkwardness' of agencies described in Chapter 1 is still not overcome. Jennings, writing in the 1930's had elucidated five circumstances under which the adoption of semi-autonomous forms of administration might be justified. This is a form of classification based on function. Firstly there was the provision of a service of a cultural or personal kind which might be distorted by political responsibility (e.g. the BBC or the Arts Council) Secondly, there were those institutions set up to enable producers to market products in an organised way. Thirdly there was the need to regulate professions such as medicine and the law, which were only subject to slight political supervision. Fourthly, there was the organisation of technical services needing little political control (e.g. the Forestry Commission). Finally, there were authorities of a quasi-judicial type, such as those set up to deal with the licensing of transport or liability to taxation. Generally, this functional classification was based on the notion that cultural, judicial and technical functions could be moved safely outside the political arena.

A final reason for the creation of agencies is sometimes given that policy makers are loath to interfere in certain important areas of economic activity such as the Stock Exchange, banking system or financial markets which are generally left to regulate their own activities (Burch & Wood, 1986). In the United States by contrast, it is a federal government agency, the Securities and Exchange Commission (SEC) which acts as a regulator. The argument for non-governmental involvement does however ignore government pressures that may be put on the sector to initiate self-regulation. Veljanovski (1990) uses the example of the liberalisation of the

financial services sector as a reason for the increase in regulatory agencies, and could in fact have added the privatisation of utility companies in the UK as a further example. A feature of agencies created by deliberate abnegation of formal authority by politicians, is that campaigns to abolish such agencies are largely ineffective (Self, 1985) as they owe their existence to political expediency.

Agency Tasks

The Pliatzky Report (1980) classified agencies by tasks, terming such bodies executive agencies, advisory agencies and tribunals. The latter function will not be examined further as they may be thought to act as 'court-substitutes', (Abel-Smith quoted in Baldwin & McCrudden, 1987), and the Franks Committee (1957) considered that tribunals should;

'properly be regarded as machinery provided by Parliament for adjudication rather than as part of the machinery of administration'.

Advisory bodies would appear to have a passive role to play in that they are unlikely to be making policy or regulations and would often function as an interface between two other parties. Thompson (1993) quotes the Advisory Committee on Pesticides and the Royal Fine Art Commission as being examples of such bodies, although he did not acknowledge the inputs to policy decisions that advisory bodies may provide.

The executive function includes a wide range of agencies, since it covers regulatory, managerial, promotional and trading functions which imply an active rather than a reactive role without necessarily incorporating a political role, as the examples of the Arts Council and the Civil Aviation Authority (also quoted by Thompson, 1993) would confirm. However, regulatory agencies may impinge upon one condition for the maximisation of agency independence set by Self (1977). This condition is that the agency should be dealing with tasks which can be treated in isolation from the rest of government. Although it could be argued that any act of regulation brings with it its own set of externalities, regulations which specifically create economic consequences may not be able to be considered in isolation from the rest of government economic policy.

Expertise is a characteristic of many specialist agencies. It is central to the use of agencies and places an activity amongst appropriately skilled people (Hague, McKenzie & Barker, 1975). Self (1977) considered that those agencies involved in the greatest amount of technical tasks were those with the highest degree of discretion. If government therefore was unable to train, recruit or retain suitably qualified staff to carry out the function itself, it may also have difficulty in monitoring the operations of a technical agency.

In the case of regulatory agencies, their general function is to serve a clientele which is normally the group that will be protected by their regulations. Self (1977), uses the Monopolies Commission as an example of an agency serving consumers and working according to their interpretation of the public interest¹⁰. The use of the term public interest is not easy to define, but in the context of regulatory agencies, it is traditionally equated with the remedying of market failures justifying intervention and is further examined in Chapter 4.

Structure And Operations

The structure and operations of an agency include both internal and external factors. Internal structure covers funding, personnel and method of proceeding, whereas external factors concern the environment in which the agency is operating. One of Self's (1977) conditions for maximising agency independence was the existence of an adequate and independent source of revenue. Certainly agency actions may be constrained if revenues are inadequate and additionally the provision of finance should be structured in such a way as to ensure that the provider does not unduly influence the recipient.

Agencies dealing with technical matters tend to have a high proportion of professional staff. Despite Self's (1977) positive correlation between discretion and expertise, nevertheless in 1985 he warned of the loss of independence where there was a close identification between an agency

¹⁰ This being the Commission's criteria referred to in the summary of all monopoly enquiries (see Monopolies and Mergers Commission annual reviews).

and a profession, a situation likely to arise where regulation of technical matters was being carried out. Not only might the professional working in the agency be influenced by their professional colleagues outside the agency who are subject to their regulations, but they may be what Wilson (1980) describes as;

'..employees who receive rewards (in status if not in money) from organised members of similar occupations elsewhere. They may hope to move on to better jobs elsewhere, but access to those jobs depends on their display of professionally approved behavior and technical competence. They may also be content to remain in the agency, but they value the continued approval of fellow professionals outside the agency, or the self-respect that comes from behaving in accordance with internalized professional norms'

(p. 374)

Additionally, the appointment system for chief executives to regulatory agencies may signify some external input which may impact upon independent decision-making, although the appointment system may be a legitimising device where the government makes the appointment.

Baldwin and McCrudden (1987) recognise three main operational choices faced by agencies. Firstly whether to proceed by way of education, negotiation or by enforcement of existing standards. Education and negotiation may emphasise a representational role, acting as a type of pressure group, whereas the enforcement role will require neutrality. The second choice involves whether its' role is going to be re-active or pro-active; will it be incrementalist or comprehensive in its approach to change. Thirdly, how are its rules to be enforced? Are they to be backed by legislation, take the forms of codes of practice or will there be adjudicatory powers? The first and third choices may well be fixed by the terms of reference when the agency is set up. This may help to define the degree of independence. The approach to problems often depends upon the environment in which the agency operates. Environmental change caused by prices or new technology affect regulatory practice. Where such an environment is changing rapidly, agencies may have to be re-active, but a case could equally be made for agencies to be pro-active in order to keep ahead of events.

For an agency to operate successfully within the liberal democratic state, it must, like any other political institution, achieve legitimacy. Baldwin & McCrudden (1987) consider legislative mandate, expertise, due process, efficiency and control as being the five criteria for achieving legitimacy. Agencies owe their origins to a number of forms which define not only their actions but also their authority. Those created by specific acts of Parliament or by Royal Charter may tend to have more legitimacy than those set up by incorporation under the Companies Acts as they can be seen to have been established with the backing of government. Baldwin & McCrudden (1987) further consider that many agencies 'operate broad mandates which are difficult to cite as convincing defences when they are under attack' p. 34. Their argument rests on the fact that the more precise a mandate is, the greater is the claim to legitimacy. In an ideal world;

'agencies might derive legitimacy through a legislative mandate in which Parliament would set down the tasks it wants agencies to achieve, attribute powers and designate both precise objectives and appropriate standards to govern agency behaviour' (p. 34)

Expertise as a characteristic was seen as essential to technical tasks being carried out but additionally it is a contributory factor to legitimacy in that specialists may be seen as having a right to exercise power in their own fields.

The due process criterion incorporates such agency procedures as participatory decision-making, consultation and openness. It also involves the question of whether decisions made are fair, consistent and equal. Use of these elements of due process does not necessarily lead to efficiency (another characteristic which may maximise independence). Additionally, outcomes arrived at by using due process may not correspond with the legislative mandate where one is in place. Participatory decision-making can involve the agency in consensus-seeking which may impact upon the impartiality of decisions, in contrast to a system of unilateral decision-making by the agency.

The criterion of efficiency is given two forms by Baldwin & McCrudden (1987). The weak form which examines whether given objectives are pursued in an effective manner suffers from inherent difficulties, given that even where a clear definition of objectives exist, there are still the

problems of measurement of success in achieving these objectives. The term 'effective manner' covers such areas as the choice of means to achieve objectives and the best employment of resources. All of this, they point out may occur in a situation where there is a mismatch between the task in hand, the strategy and the regulatory institution itself. The strong form of efficiency involves an assessment of the consequence of decisions, which should have as a pre-requisite, a consensus as to distributional matters.¹¹

Accountability

Within liberal democracies, a feature of governments is that they should be both representative and responsible (Birch 1964). Although there is no single interpretation of 'representative' (see Dunleavy and O'Leary, 1987), responsibility itself implies various concepts, including responsiveness, good conduct and accountability. The expression 'stewardship of the public interest' (Oliver, 1991, p. 23), could be said to summarise these areas. The UK constitution (although unwritten), provides for individual ministers being accountable to the elected assembly for the work of their departments and the cabinet being collectively responsible for government policy. Writing in 1864, John Stuart Mill outlined how this should work, 'It should be apparent to all the world who did everything, and through whose default anything was left undone' Mill was describing a clear relationship between power and accountability within the context of the state exercise of power. The eighteenth century had however already seen the creation in the UK of certain non-governmental agencies and by the early part of the twentieth century, the constitutional awkwardness of having powers exercised outside of central government had already been recognised on both sides of the Atlantic (Jennings 1930, The Presidential Committee 1937). More recently, in the UK, interest in accountability would appear to have increased partly in response to changes in the structure of providing public services. A study by Stewart, Lewis and Longley (1992) concluded;

"Those who exercise public power in society should be answerable for the exercise of that power...Such powers are

¹¹ This might require the designation of precise objectives as well as appropriate standards as quoted on the previous page.

only justified if those who exercise them are answerable to them (the citizens). The powers, it can be argued, do not belong to those who exercise them, but belong to the citizens on whose behalf they are exercised. That relationship is only justified if there is accountability' (p. 4, brackets added)

The Stewart et al (1992) argument rests firmly on the use of accountability as a legitimising device. Within a liberal democracy, elections serve the functions of both conferring power and calling to account those who have been exercising powers during the preceding period. Stewart et al (1992) recognised that the traditional forms of public accountability may not, in fact achieve their objectives and that this problem is compounded by a more complex society and a more questioning public. Within a democratic state therefore, it is axiomatic that the exercise of power carries with it the obligation of accountability¹². Thus an organisation which is carrying out the exercise of power which otherwise might be wielded by the state should similarly be accountable.¹³ However, due to the use of agencies, traditional political accountability cannot be assumed. Therefore new forms of accountability have been identified (Smith, 1980) to overcome this problem.

THE REGULATORY ENVIRONMENT

Each regulatory agency operates within an environment in which one group is regulated for the benefit of others. Both of these actors have an incentive to influence the actions of the regulators for their own purposes. One of Self's (1977) conditions for maximising the independence of agencies was the absence of a powerful interest groups of clients. This tends to occur where either costs or benefits are likely to be concentrated

¹² There are however degrees of accountability and writers such as Mayston (1993) consider that government in general in the UK is becoming less accountable. This situation, coupled with growth in the exercise of power by agencies, implies a general reduction in accountability by those who exercise power towards those on whose behalf it is exercised.

¹³Baldwin and McCrudden consider that the rendering of power is more acceptable where '... an agency might be made accountable for its interpretation of its mandate to a representative body...' p 36. The notion of control is central to the independence of an agency. If accountability implies control, then independence would appear to be minimised. Baldwin and McCrudden use the term control synonymously with accountability.

on one group. Where this arises then Wilson (1980) describes three potential systems of politics arising¹⁴, interest group politics, client politics or entrepreneurial politics and in each case pressure groups have every incentive to organise and take action.

Interest group politics arise where the regulation under consideration will benefit a small group at the expense of another small group. In this case, each side has a strong incentive to organise and attempt to exert influence. The general public, although possibly sympathetic to one side or another will not actively participate in the process. Client politics results where the benefits are likely to be concentrated, while the costs are widely diffused. The potential beneficiaries are likely to unite to support the proposition. Finally, entrepreneurial politics arise where a relatively small benefit is generally conferred at costs to be born by a small segment of society and this segment will organise to attempt to defeat the regulation. In the case of accounting regulation, in place of the usual producer and consumer examples, we find preparers and users¹⁵.

Accounting Regulation

The three different agencies involved with accounting regulation in the UK since 1970 were described in the previous chapter. By contrast, the US experience of private sector accounting regulation has been longer (since 1959), but with only two bodies, the Accounting Principles Board (APB) and the Financial Accounting Standards Board (FASB). Already a divergence from the definitions of agencies given at the beginning of this chapter, can be seen with the US (and subsequent UK) use of 'Board' being somewhat at odds with Chandler & Plano (1988) who would have preferred the use of 'Commission' to indicate the regulatory function. Until 1990, the use in the UK of the word 'committee' described the origin of the ASSC, which was incorporated as a committee of the ICAEW (Howlin & Skerratt, 1992; Taylor & Turley, 1986). The subsequent retention

¹⁴ Wilson does describe a fourth system where both costs and benefits are widely dispersed and there is little incentive for interest groups to participate.

¹⁵ Chapter 9 applies Wilson's types of politics to the accounting regulatory environment.

of 'committee' from 1976 onwards reflects the view of the ASC as a joint committee of the CCAB (Taylor & Turley, 1986) .

Despite differences in both structure and operations, all these bodies have carried out functions which would otherwise have fallen to government. Indeed these functions can be seen to be carried out by government in such countries as France and Germany (Nobes & Parker, 1995), and prior to the introduction of the UK Statements of Standard Accounting Practice (SSAP's), the government might be considered to have been at the forefront of accounting regulation through the Companies Acts¹⁶. Accounting regulatory bodies act in a similar way to any other agency, carrying out some task of public policy possibly using public funding but nevertheless also receiving some measure of voluntary or private enterprise resources (the tasks and the resourcing of agencies are looked at in Chapters 4 and 5). Although the regulation of accounting may be thought of as different from other types of regulation which often deal primarily with pricing matters, nevertheless the objectives of regulation remain the same, i.e. some form of the promotion of the public interest by increasing the welfare of groups affected by accounting. Indeed in other examples of regulatory activity, the quality of the product also falls within the remit of the regulators¹⁷. Daley and Tranter (1990) seem quite clear in contextualising accounting in this way, claiming;

'Setting forth rules that govern the form and content of information which is disseminated from business organizations to the public is a form of regulation'. (p. 16)

The independence-maximising characteristics described in this chapter can thus be applied to accounting regulators. The relatively short experience of private sector regulation, allows its origins to be examined in the context of recent history. The tasks of the regulators are well defined and contained within the written constitutions of the UK accounting regulatory bodies. Their structure and operations are partly visible

¹⁶ Especially if the Recommendations of the ICAEW are considered as guidance rather than an attempt at regulation.

¹⁷ The utility regulators in the UK are also concerned with the quality of service.

through the financial press and technical publications as well as through examining the archives of the Accounting Standards Committee. The regulatory environment occurs because of interaction between the regulators, the regulated and those on whose behalf the regulations are framed. Each accounting standard issued whether in draft or final form represents an arena in which the various interests can be viewed.

SUMMARY

Accounting regulation would appear to concur with the paradigm of regulation and therefore the analysis of both the structure and other characteristics of accounting regulatory agencies may be made using both theories and descriptions derived from other agency types. The problem of providing a definition and therefore being able to identify and classify agencies was addressed. A functional definition of an agency as an organisation carrying out tasks which might otherwise fall to government would appear to solve the problem of identification, but not of classification, because of the array of structures, functions and constitutions such bodies possess. Previous research into agencies tends to have used characteristics rather than classifications, and although these characteristics are numerous, they tend to fall within three main categories: 1) motives for agency creation 2) agency tasks and 3) structure and operations. Each of these characteristics may be seen to impact upon the independence of the particular agency being examined.

The motives for creation could either maximise or minimise the independence enjoyed by an agency, in that the agency may have been set up precisely to avoid any form of undue influence, or alternatively in order that it may be seen to be independent, whereas it is in fact being controlled. Agency tasks may by their very nature, insulate the regulators from an untrained clientele, although this might imply that the agency is controlled by a small elite. Internal characteristics such as funding or personnel can impact upon impartiality through self-interest, and the external environment defines the pressures faced by the regulators. The following chapters examine each of these sets of characteristics insofar as they apply to the UK accounting regulatory bodies although the US is used for comparative purposes where relevant. Relevant theories are applied to the motives for agency creation and their internal characteristics, and the

external environment is examined through the use of case studies tracing the development of two accounting standards.

CHAPTER 3

MOTIVES FOR AGENCY CREATION

INTRODUCTION

The previous chapter identified those characteristics which affect the independence of agencies. The subsequent five chapters examine those characteristics in depth, applying them to accounting regulatory bodies in the UK. The first characteristic, the motives for agency creation is significant in that the agency may be set up outside of government specifically to insulate it from political pressures. This could apply equally where either the government or the private sector creates the agency. Indeed, from the 1930's onwards, constitutional lawyers and political scientists have looked at both the justification of the use of agencies and the advantages of regulation and administration carried on outside of government.

This chapter commences with an examination of two different accounting regulatory classifications. Within these, examples are given of different regulatory arrangements for comparison purposes, both in European countries and other major industrialised nations. As many aspects of society are regulated and controlled by government there would appear to be a compelling argument for accounting regulation to be a function of the state, especially in view of the economic consequences outlined in Chapter 1. In any case, private sector agencies would appear to operate only with the implicit or explicit consent of the State who could over-rule any decisions made with legislative action, or in an extreme case, outlaw the agency¹.

The approach of this chapter is to look at the justifications of the use of a private sector agency to regulate accounting in the UK. An examination of

¹ The relationship between the accounting regulators and the state is extremely complex. Evidence is given in later chapters as to incidents of both conflict and mutual support.

the general features of accounting regulatory bodies has been made, as well as a more detailed approach to demonstrate the operations of the standard setters. For this, the development of two standards has been selected, SSAP 20 (Foreign Currency Translation) and SSAP 22 (Accounting for Goodwill). These two standards have been selected because they offered choices of accounting treatments, their development covered a significant period in the life of the ASC (1977 to 1984) and because records relating to their development were available at the ASC archives.

CLASSIFICATIONS OF REGULATION

At the extremes of the regulatory continuum are the state and the market. These do not simply mark the parameters of possibility; examples exist of the state control of accounting under authoritarian regimes in former Communist countries and also of the market, especially in UK company accounting in the nineteenth century, where disclosure was felt to be a matter of negotiation between directors and shareholders². The model illustrated below, was developed by Puxty, Willmott, Cooper and Lowe (1987), and illustrates the three possible influences on accounting regulation, the market, the State and the community.

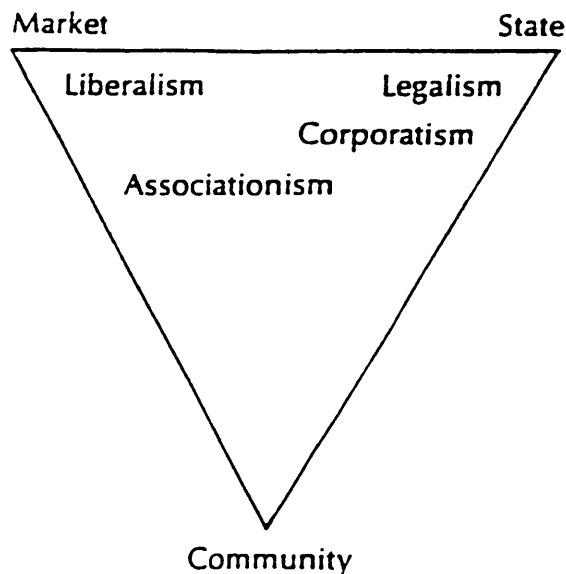


Figure 3.1 Regulation of financial reporting. (Source: Puxty et al. (1987) p. 283.)

² See for example Edey and Panitpakdi (1956).

Within these parameters lie the four modes of regulation. Liberalism and legalism are explainable in terms of the extreme examples already quoted, but Puxty et al (1987) introduce Associationism and Corporatism as intermediate types and it is the extent to which the community is represented that tends to differentiate between these two modes. In the former (Associationalism), organisations formed to advance the interests of their members control the regulatory process, whereas under Corporatism, the state incorporates certain interest groups into its own system of regulation in an attempt to achieve public rather than market purposes. Under both of these systems, the community is not totally excluded, but only a part of it tends to be represented. The application of the study of accounting regulation by Puxty et al (1987) to four countries produce the following results:

- | | | |
|----------------|---|--|
| United States | - | Elements of legalism and associationism with the latter subordinated to the former |
| United Kingdom | - | Principally associationist |
| Germany | - | Legalism predominant |
| Sweden | - | Corporatist |

It must be remembered however, that the study was based on the ASC rather than the ASB, and the formation of the new body may indicate a movement towards Corporatism.

The above classification tends not to differentiate between the making of rules and their enforcement. Nobes (1992{b}), however incorporates both functions in his regulatory classification. State regulations are subdivided into those which are statute based only, and those which have a government committee forming an input into the system. This would tend to move somewhat towards a more corporatist model, although this may not involve the community in general³. Like any attempt at classification, the results for all countries do not fit perfectly. As this study is concentrating on the UK, it can be seen on the Nobes diagram reproduced on the following page, that a feature of the UK scene is

³ Assuming that 'community' represents all interests in society.

described as independent creation with professional enforcement, once again reflecting the ASC rather than the ASB.

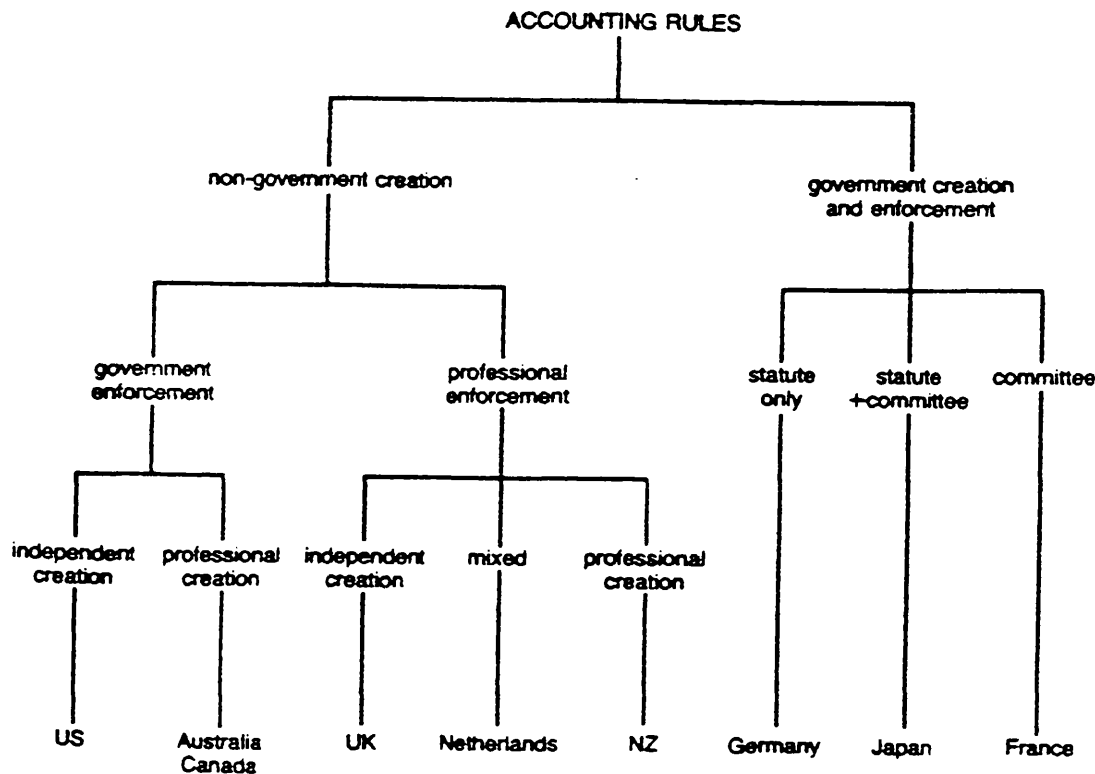


Figure 3.2 International classification of creation and enforcement of accounting rules.
(Source: Nobes (1992[b]), p. 101)

The classifications demonstrate an array of different sources of regulation, many of which in practice emanate from the State. Given the predominance of the arguments that state power is increasing and concerns voiced at 'big government' (see Rose, 1976), it may seem paradoxical that accounting as a significant instrument of economic and social control has escaped direct state regulation in so many countries of the world. The existence of private sector regulation by either government sponsored or government tolerated agencies, would imply that there are advantages in this method of operation which appear to outweigh the disadvantages of allowing power to be exercised outside of

the State. The following sections examine some of these possible motives for the existence of agencies and explains those advantages.

EARLY THEORIES OF AGENCIES

Two of the Jennings' (1930) justifications for agency use outlined in the previous chapter, are not applicable to accounting regulators. The third 'circumstance' (as he termed these conditions), i.e. the regulation of professions, could apply to the professional associations of which accountants are members, although under the pre 1990 accounting regulatory system it was through their membership of the CCAB that these associations were responsible for issuing standards and ensuring compliance. In their early existence, they were responsible only for matters of training and discipline (Zeff 1972), but as they took on more responsibilities for issuing technical guidance then this gave them a more regulatory role. Once the ASSC was established, the accounting bodies gave up their accounting rule-making functions and it was this new body which attempted to control indirectly the actions of accountants insofar as technical issues were concerned. The organisation of technical services needing only slight political control was the fourth justification given by Jennings. This would appear to apply in the absence of external effects caused by these 'services', but the identification of the economic consequences of accounting and the placing of accounting within a political framework⁴ means that this circumstance cannot be applied to accounting⁵.

The ASC never performed the final judicial role described by Jennings, delegating matters of enforcement and interpretation to the separate member bodies of the CCAB. Insofar as the current structure for accounting regulation is concerned, the Review Panel (RP) does indeed have a quasi-judicial function in that it is the body which examines what it considers to be breaches of accounting rules and is able to negotiate remedies and in the final instance recommend prosecution to the

⁴ According to Cooper & Sherer (1984), value judgements made by regulators imply that the interests of some groups are emphasised at the expense of others.

⁵ Jennings was writing as a lawyer rather than as an economist.

Department of Trade and Industry, but it does not have the ultimate power of making judicial decisions.

MODERN THEORIES

The most comprehensive analysis of motives for agency creation, appears to have been supplied by Baldwin and McCrudden (1987). Their arguments related mainly to those agencies and other bodies which had been set up by government, but may be equally applied to self-regulation within the private sector whose activities could be curtailed or assumed by the government if they so wished. The Financial Services Act of 1986 which empowered the Securities and Investment Board (SIB) to grant licenses to investment businesses and monitor authorised firms are an example of government instigated self-regulation. Similarly, the Companies Act of 1990 recognises the ASB as the official accounting standard setting body under Section 256(1), although the government were not the instigators of the formation of the Board⁶.

The Baldwin & McCrudden 'Motives'

A) Ability to involve the public in decision-making.

Within the area of accounting regulation, public involvement could take place either through membership of the regulatory body or through attempts to influence such a body. Following the Watts Report (1981) the membership of the ASC was changed from consisting exclusively of members of CCAB bodies to include representatives of user groups. The process of setting standards was however still dominated by the accounting profession and at no time during the life of the ASC were there more than two individuals who were not also members of CCAB bodies⁷. Enforcement of regulations (or lack of enforcement), was carried out by the accounting bodies themselves. Under the ASB, appointments are made to the Board by an appointments committee of the Financial Reporting Council; thus the Board may not necessarily be dominated by accountants.

⁶ However as will be seen in Chapter 5, the executive appointment system is the same for the SIB as for the FRC.

⁷ See Chapter 5 for a full analysis of members.

Involvement by external parties in the case of individual accounting standards arises from the system whereby consultations are held with interested parties and comment letters are received in response to exposure drafts. These comment letters are all evaluated by the standard setters before either re-issuing the draft or issuing the standard.

In the case of Accounting for Foreign Currency Translations, three Exposure Drafts were issued, ED 16, ED 21 and ED 27, although the first of these was a proposed supplement to SSAP 6, Extraordinary Items and Prior Year Adjustments. Out of 79 replies to the first Exposure Draft, only 51 commented on foreign exchange and out of these, the majority commented on foreign exchange gains and losses in relation to extraordinary items with little mention of the substantive issues which were to be addressed by later Drafts. Before the issue of ED 21, which dealt comprehensively with the methods of translation and matters of profit recognition, a meeting was held on 18th April 1977 between members of the ASC and representatives of major companies to discuss the proposed standard. This was recorded in a letter dated 29th July 1977 from J Carty of the ASC to M Thornton of the Economic Intelligence Unit of the Bank of England;

'ASC held a meeting of representatives of 20 major companies
whose accounts are affected in a material way by foreign currency
transactions' (ASC 2/8/4)

After ED 21 was issued in September 1977, a meeting was held by representatives of the ASC with the Finance Directors of 42 major companies (ASC 2/30/2). Prior to the issue of ED 27, evidence exists of preliminary drafts of the ED being sent to Cadbury Schweppes, Unilever, P & O, Metal Box and I.C.I (ASC 2/37/2). Not only were companies targeted for comments, but also analysts. In a letter to B Ogle of the ASC, Pauline Wallace, the under-secretary writes;

'I did speak to an investment analyst at Phillips and Drew and was
advised that this should give the information which they require'
(ASC 2/29/3)

As part of the consultation process, 41,400 copies of ED 27 were distributed in October 1980 and the text was reproduced in the technical and professional press (ASC 2/29/3). In reply to this, some 107 letters were received by the ASC⁸. Additionally in 1981, two public meetings were held on 20th and 27th February. These meetings consisted of submissions made by one company, two professional firms and three academic establishments (on 20th February) and four companies and two professional firms (on 27th February)⁹

The Exposure Draft 30 Accounting for Goodwill was issued in October 1982 and there is less evidence of consultation than in the previous example. Some 20,000 copies of the Exposure Draft are reported as being distributed with the text being reproduced in the professional and technical press (ASC 1/78/2). In reply to this, 97 comment letters were received. Previously, Peter Holgate of the ASC visited a number of companies who had recently had major acquisitions or mergers (ASC 2/61/3), and there exist notes of a meeting held with M Sorrell of Saatchi & Saatchi on 8th July 1983 (ASC 2/61/2). On 13th March 1984, a working party reported to the planning sub-committee the following consultations:

- 1) companies which had recently made major acquisitions
- 2) companies which in their comments on ED 30 had indicated a particular problem
- 3) ASC's legal advisers
- 4) Royal Institute of Chartered Surveyors (RICS)
- 5) the CCAB member's technical committees

In general, the ASC did not appear to be constrained in its ability to involve the public in decision-making. It had freedom to make appointments both within its' main and sub-committees and in its'

⁸ This could imply agreement with the Draft, lack of interest, wrong targeting of interested parties, a lack of belief that replies would be taken seriously or perceived costs of lobbying in this way. As far as the writer is aware, there is no research into the reasons for non-involvement.

⁹ Accountancy in April 1981, reported 'a steady dozen in the audience'.

working parties. Despite the fact that consultation would appear to have been made mainly with one group, preparers rather than users, nevertheless the ability to consult with interested parties was available, and the Exposure Drafts appear to have been widely circulated¹⁰. Although consultation at the draft stage appears to have been comprehensive, nevertheless it was the accounting profession who tended to be involved, although it could be argued that technical matters could not be considered by laymen. Public hearings might have been a way to make the consultation process more visible, but their use, in contrast to FASB, was very rare in the UK.

B) Giving the appearance that the Government is doing something.

Initial demands for actions tend to be made to the government. Where accounting is concerned, governments have often referred in written and verbal replies to Parliamentary questions, to work being carried out by the accounting profession, and by expressing their confidence, have intimated that the problem is under control. An example of this arose in 1970 when the then Secretary of State was asked to take steps to encourage the standardisation of accounting practices. The formal reply stated that the ICAEW together with the Scottish and Irish Institutes were working on this in accordance with the 'Statement of Intent' of 1969 issued by the ASSC (Hansard, Vol 807). Following the publication of the Sandilands Report in 1975, the President of the Board of Trade announced in Parliament;

'...that the accountancy profession has agreed to set up a steering group as recommended by the Committee, to consider further the practical and other issues involved, with a view to the implementation of CCA in company accounts....'

(Hansard, vol. 901)

More recently, the government has deflected questions on accounting by reference to the ASB. On two occasions, John Redwood of the Department of Trade and Industry has, in the case of foreign exchange stated;

¹⁰ Perhaps too widely as the response rate might indicate, although this wide circulation could be interpreted as legitimising the process through the involvement of the accounting community.

'The requirements of SSAP 20 are a matter for the Accounting Standards Board'

(Hansard, Vol. 182)

Faith in the regulators was also expressed by him on a more general basis in another reply, this time in the context of goodwill;

'Issues of this sort are better dealt with through accounting standards than the law'

(Hansard, Vol. 183)

Demands for action were effectively 'delegated' by government to the accounting standard setters through its own inaction, giving the appearance that some steps were being taken elsewhere with the government's blessing. Luehlfiing (1995) describes a hypothetical situation of a public outcry over some accounting failure, followed by the promise of action by the accounting establishment. The government is then provided with an alternative to legislation and assures the public that it will be monitoring the actions of the accountants.

C) The political dangers of policy administration.

Wallace (1980) suggests that self-regulation provides a form of self-insurance for politicians and bureaucrats, giving them the opportunity to shift politically costly future events to the private sector. Accounting in general is not a vote-winning issue with Wilson (1980), describing how elections are won or lost on issues of personal income or national security rather than regulatory matters. Lewis (1985) aligns this idea to his 'escape theory', under which, in addition to avoiding parliamentary checks and financial control to which Departments would be subject, agencies can produce desirable results (from the government's point of view) without the government having to take unpopular actions. This aspect of agency use, he terms the 'poison chalice'.

Inflation accounting provides an example of a potentially dangerous area for government. The high levels of inflation of the early 1970's made it necessary for some action to be taken in order to prevent erosion of capital and to allow for comparability of results, but solutions to accounting for

changing price levels have always been both radical and controversial¹¹. Although it was the government that set up the Sandilands Committee, few elements of inflation accounting were incorporated into Company Law. It was the standard setters who had to issue a provisional SSAP (PSSAP 7 advocating Constant Purchasing Power (CPP) accounting). This was then withdrawn and replaced by SSAP 16 which was initially issued as a mandatory statement, then became voluntary before finally being withdrawn. From the time of Sandilands Report being produced, it was possible for the government to back away from the situation.

ED 30 Accounting for Goodwill, could be seen as being as being politically dangerous due to the effects of the accounting treatment on the acquisitions market. During a meeting between M Sorrell of Saatchi and Saatchi and the ASC;

'Mr Sorrell claimed that a number of the acquisitions over the past few years would not have taken place had ED 30 been in force as a standard.'

(ASC 2/61/2)

In the event, SSAP 22 was issued allowing not only a choice of treatments of goodwill on acquisition but also allowing selective use of either treatment. The 'weakness' of the solution was not of the government's making.

The impact of floating exchange rates brought about the necessity for a foreign exchange translation standard in the 1970's (Blake, 1994; Kettell, 1978). However, ED 21 was described as 'coming down firmly on both sides of the fence' (Accountancy, 1977). One of the main problems was the tension between the US standard (Statement of Financial Accounting Standard (SFAS) 8 advocating the temporal method) and the current practice in the UK (use of the closing rate method). The US had already experienced the difficulties that could be caused by a depreciating currency;

¹¹ For example, the use of entry or exit values require a fundamental change in certain accounting assumptions.

'The Americans, after years of accepting the results produced by the temporal method, have come to the conclusion that the results produced by that method are now meaningless. In fact, it now produces a huge loss because the weakness of the dollar; and American industry, in these circumstances, feels that it is totally unacceptable.'

(Accountancy 1979 p. 1)

In a volatile situation where appreciating or depreciating currency will effect gains or losses depending upon the translation method used, there is little to be gained by a government in becoming involved in this area where the result of action is likely to be random.

D) Deflection of lobbying and requests for political favours

Overt lobbying of accounting standard setters occurs through comment letters based on Exposure Drafts. The replies to the exposure drafts in respect of foreign currency and goodwill are as follows:

Table 3.1 Replies to exposure drafts on foreign exchange and goodwill.

Foreign Exchange	ED 16	51 replies
	ED 21	119 replies
	ED 27	107 replies
Goodwill	ED 30	96 replies

These replies represent an array of preferences, all of which were studied and noted by the members of ASC and by the working parties. In addition to this channel, informal lobbying may also be carried out through the meetings of ASC representatives with companies, through membership of ASC committees and sub-committees and through personal contacts. The government could probably not avoid all pressure group activity as lobbyists would realise that the government also has powers through the Companies Acts to effect accounting changes¹², although the reliance placed by the government on standard setters is evidenced both through

¹² The cases of lobbying government are better documented in the US, see the examples quoted in Chapter 1.

the few Parliamentary questions on matters of accounting detail¹³ and the endorsement of the revised structure for accounting regulation by the 1989 Companies Act and by Parliament (Hansard Vol. 174)

E) Avoidance of awkward or burdensome duties being added to departments or courts

The involvement of the Department of Trade (Now the Department of Trade and Industry) in the formulation of the standards on both foreign exchange and goodwill was mainly from a consultation rather than from a lead point of view. It was the ASC which carried out the preparatory studies and the ongoing processes as detailed below, consulting with the Department as felt necessary. The workload for production of the standard for foreign exchange was extremely great for the ASC, consisting of the following steps, identified from the ASC archives :

Table 3.2 The chronological development of SSAP 20.

Month/year	Operation/Task
1976	Research study by Professor Flower/ Arthur Anderson
4/77	Meetings with major companies
6/77	Text of ED produced
8/77	Postal ballot of ASC members
9/77	ED 21 Issued
11/77	Conference held under B Ogle
4/78	116 replies received
4/78	Deloitte make member of staff available to analyse comment letters
5/78	Panel reviews comment letters
1/79	Panel reviews Exposure Draft
8/79	Meetings with FASB in US

¹³ See the earlier quotations from John Redwood.

11/79	Meeting with 42 major UK companies
7/80	New draft sent to 34 companies
9/80	Revision of draft
2/81	Public meetings
1981-1983	Resolution of legal difficulties
4/83	SSAP 20 issued

These are only the stages in the process mentioned specifically in the ASC archive material. No evidence exists of what must have been the considerable task of drafting the six versions of the ED (the number of versions mentioned in a memo from Pauline Wallace (the under-secretary of the ASC) to ASC members dated 5.8.81, (ASC 2/40/2). Additionally meetings of the ASC regarding the Drafts and discussion between members remain unrecorded although it could be safely assumed that these occupied a great deal of time, and yet this standard was only a part of the ASC's workload. During the period from the issue of ED 21 (Accounting for Foreign Currency Transactions) in September 1977 through to the issue of the related standard SSAP 20 (Accounting for Foreign Currency Translation), the following accounting standards and exposure drafts were issued:

Table 3.3 ASC standards and drafts issued 1977-1983.

SSAP 12	Accounting for Depreciation	December 1977
SSAP 13	Accounting for Research and Development	December 1977
SSAP 14	Group Accounts	September 1978
SSAP 15	Accounting for Deferred Tax	October 1978
SSAP 16	Current Cost Accounting	March 1980
SSAP 17	Accounting for Post Balance Sheet Events	August 1980
SSAP 18	Accounting for Contingencies	August 1980
SSAP 19	Accounting for Investment Properties	November 1981
ED 30	Accounting for Goodwill	October 1982

ED 31	Accounting for Acquisitions and Mergers	October 1982
ED 32	Disclosure of Pension Information in Company Accounts	May 1983

Had the Department of Trade and Industry assumed responsibility for incorporation of all these issues into company legislation, then the burden on the Department would have been considerable and progress may have been slower.

As well as reducing the burdens on government, the work of the courts may be reduced by meetings to discuss those areas where standards might be in conflict with the law. In the case of the proposed standard on foreign exchange there was a very real danger of future conflicts between accounting and the law in the area of legally distributable profit. Until the Companies Act of 1980, there was practically no mention in UK law of distributable profit. Table A of the Act stated that no dividend should be paid otherwise than out of profits. Case law had given little guidance on the subject, sometimes producing contradictory and confusing judgements¹⁴. The 1980 Act introduced specific rules as to the reserves that could be used for the purpose of a distribution. The main problems however were caused by the implementation of the EC Fourth Directive in the Companies Act 1981. Schedule 1 of the Act required companies to take account of profits only to the extent that they were realised. ED 27 however allowed exchange gains and losses on long-term monetary items to pass through the profit and loss account. Prior to the issue of ED 27 in October 1980, the ASC had been 'warned' of the impending problems. A letter dated 7.5.80 from F Jenkins of the Department of Trade to J Carty the ASC secretary stated;

' At the very least it will be assumed that compliance with a SSAP would not involve any risk of infringing the statutory requirements.....we think it important that the ASC should consider the treatment advocated in the proposed exposure draft in

¹⁴ See for example Napier and Noke (1992).

the light of the imminent and prospective statutory position in the UK' (ASC 2/30/2)

The treatment of gains on long term monetary liabilities proposed by ED 27 did cause problems at a later date. At a meeting with the ASC, the Department of Trade explained that the treatment contravened S. 12 of the 1981 Companies Act. The ASC argued that this was a special circumstance in accordance with S. 15 which permitted a departure from accounting principles where it appears to the directors of a company that there are special reasons¹⁵. The DoT response was that particulars of the departure would have to be disclosed along with reasons for the departure and its effect on the financial statements. (ASC 2/29/3)¹⁶. The matter had thereby been resolved before a specific case arose.

On 29th July 1982, the ASC consulted with learned counsel, T Curry QC regarding the legal aspects of the proposed standard (ASC 1/9/1). The Standard was to run into one more problem when one member of CCAB (ACCA) requested that the standard should not apply to banks. Once again, the ASC was forced to take legal advice on this matter and consulted the legal firm of Slaughter and May who clarified this point by letter on 7th and 13th December 1982 (ASC 1/9/1).

In the case of ED 30 Accounting for Goodwill, there do not appear to be the same conflicts between accounting and the law. Indeed a suggestion was made in a letter from J Knox of the DoT to K Wild of the ASC (16.10.80) that the panel on goodwill be reconstituted to reply to the draft 7th Directive. (ASC 2/9/4). Previously, a request had been made to Knox to check with his legal staff, matters of legality of the proposed treatments of goodwill (ASC 2/24/1). A meeting was held with Jenkins of the DoT on 1.4.82 to discuss legal aspects of the draft and Jenkins replied to Renshall of

¹⁵ As this dealt with an accounting principle, S 15 was applicable rather than the use of the true and fair override.

¹⁶ The professional press at the time interpreted the DoT's reaction as signifying reluctance to accept the special reasons argument and commented that although the definition of 'realised' had been pinned to Generally Accepted Accounting Principles (GAAP), there was more than one interpretation of GAAP (Accountancy, 1982).

the ASC commenting on the reconciliation of the proposed standard with the law (ASC 2/89/1) Prior to the issue of the standard in December 1984, legal advice had been obtained throughout the year on the appropriateness of the writing-off of goodwill to unrealised reserves (ASC 2/47/2).

Despite these conciliatory actions, nevertheless Napier and Noke (1992), suggest that the relationship between accounting and the law remains unstable, especially due to what they describe as a more aggressive approach by accounting. Despite this, few legal cases with the exception of revenue law are centred around financial reporting. It may be that 'behind the scenes' negotiations and the frequent use of legal opinions prevents such cases coming to court.

F) Better administration, specialisation and expertise.

The regulation of accounting concerns highly technical issues for which expertise is needed. Expertise in dealing with these issues is usually found in qualified professional accountants. Howlin & Skerratt (1992) describe how following a change in the ASC constitution in 1976, 12 of the 23 members were to be appointed by the ICAEW, the remaining 11 members being divided almost equally between the ICAS, ICAI, ACCA, ICMA and CIPFA. The 1982 constitution stated that up to 5 of the 20 places should be reserved for users of financial accounts, who need not be members of any of the CCAB Consultative Committee of Accounting Bodies) bodies¹⁷. All CCAB members had however to agree accounting standards before they could be issued, as such standards were enforced by the individual member professional bodies. Not only was the regulatory body run mainly by members of the main accounting institutes, but much of the process of consultation was also dominated by the accounting profession. In the case of the Foreign Exchange Drafts, the following represents members of CCAB bodies identified as responding to the Drafts:

¹⁷ Chapter 5 contains a fuller analysis of members.

Table 3.4 CCAB members responding to ED's 16,21 and 27.

ED	Professional Firms	Technical Advisory Committees/Institutes	Industry
16	16	15	18
21	24	24	30
27	20	12	18

The total of respondents for each draft were as follows; ED 16: 51, ED 21:116, ED 27:107. In the case of ED16, only those replying in respect of the foreign exchange elements of the standard have been included. In the industry figure, only ICAEW members have been included where it was possible to identify them specifically from the relevant list of members for the year¹⁸. In view of the positions held by the other industrial respondents, e.g. financial director/controller, accountant, it is unlikely that they would not be members of one of the CCAB bodies.

The government would appear to lack the expertise in matters of accounting that exist within the private sector. Parliamentary questions were frequently posed both verbally and in written form regarding the shortage of qualified accountants in government departments. Moran (1988) quotes Gower (1984 p. 21) as claiming that in 1984, the Companies Legislation Division of the DTI had no lawyer or accountant, and only four staff who had been in post since 1980. This situation was accounted for by wage differences between the civil service and industry and the professions, and the nature of accounting in the civil service, relying on cash rather than accrual accounting meant that there did not exist the experience of the complex issues faced by businesses. Baldwin & McCrudden (1987) also put forward the theory that it is not only expertise but also administration which can be better organised by an agency because the function is;

¹⁸ Professional associations' list of members do not always include the company affiliation of members.

‘the sole or central interest of the organisation, and not just a peripheral matter dealt with by someone whose attentions are primarily directed elsewhere.’ (p. 4)

If the detailed regulation of accounting were left to the government, it would in all probability be the Companies Division of the DTI and might well become a ‘peripheral matter’.

Beresford’s (1995) arguments for setting standards in the private sector are that a;

‘private-sector board brings greater expertise to the table. It can attract board members and staff with the requisite practical experience, compensate them appropriately, retain them for a sufficient period and provide the support services necessary for them to do their jobs.’ (p. 59)

In addition, Lewis (1985) writing about agencies in general, puts forward the idea that non-governmental officials are more likely to be able to harness individual enterprise and initiative for the public good, due to the;

‘different experiences, working methods and mode of organisation other than those normally found in government departments...’ (p. 206)

G) Speed of Decisions

Lewis (1985) justifies alternative structures to traditional bureaucracies on the grounds of introducing a more flexible and adaptive approach to matters. Speed of decisions and freedom from technicalities are an advantage enjoyed by the agency form. Since the formation of the ASSC in 1970 until its demise in 1990, there have been only four new Companies Acts (1976, 1980, 1981 and 1989). The regulatory output of the ASC is listed in its final ‘Report and Recommendation’ to its governing body the CCAB for the final meeting on 25th July 1990;

‘ASC (under its original title of the Accounting Standards Steering Committee) held its first meeting in December 1969. During its existence it has issued 55 Exposure Drafts, 2 Statements of Recommended Practice, 28 discussion papers and other documents.

Thirty four Statements of Standard Accounting Practice have been recommended to and approved by the governing bodies'.

(Renshall 1993)

Although in certain areas the length of time between issue of a first draft and the standard has been considerable, e.g. ED 16 September 1975 to SSAP 20 April 1983, nevertheless the sheer volume of the output of the ASC indicates that the decision-making process was efficient and able to cover areas on which company law was silent. Patient (1992) describes how '...between such Acts the accounting profession played its part' (p. 24). The current structure of accounting standard setting allows even greater speed of decisions, in that the ASB issues standards in its own right without having to seek approval from a higher body and has the ability to work on a majority basis. Additionally the Urgent Issues Task Force is able to issue 'Abstracts' which come into force immediately and have the same powers as standards. From the inception of the UITF in 1990 to the end of 1996, some 15 abstracts have been issued.

H) Agencies are not restricted to formulating policy on a case by case basis

An agency is able to develop a long term and consistent policy. In the development of accounting regulations, consistency is important because it is considered an essential characteristic in accounting (Solomons 1986, Underdown & Taylor, 1985), and indeed is a fundamental concept under SSAP 2. One of the ways in which consistency may be achieved is through a conceptual framework. Indeed Carsberg's (1984) definition of such a framework contains the term;

'In essence, a conceptual framework comprises a set of basic principles that command general support and can be used to help with detailed decisions by increasing the likelihood of consistency and reducing the costs of analysis.'

(p. 25)

Attempts, with varying degrees of success have been made in the UK to develop such a framework. Although SSAP 2 issued in 1971 covers some of the ground of a conceptual framework, it could not be given that title. The Corporate Report issued by the ASSC in 1975, although lacking the robustness of later studies, may have been the first real attempt to develop a conceptual framework in the UK in that it deals with;

'the fundamental aims of published financial reports and the means by which these aims can be achieved' (p. 3)

A consultative document issued by the ASC in 1978, 'Setting Accounting Standards' asked whether the ASC should encourage research into a conceptual framework¹⁹. Following the negative conclusions reached by Macve in his 1981 report for the ASC, initiatives in this direction passed to professional bodies (e.g. ICAS, ICAEW). The ASB however has seen the formulation of a conceptual framework as being a priority;

'FRS's are based on the Statement of Principles for Financial Reporting being developed by the Board, which addresses the concepts underlying the information presented in financial statements. The Board is developing this statement of principles to provide a framework for the consistent and logical formulation of individual accounting standards. The framework also provided a basis on which others can exercise judgement in resolving accounting issues' (ASB 1991, para 4)

The production of a conceptual framework if this were possible, would allow consistency between rules and prevent apparent anomalies arising between accounting concepts such as accruals and prudence. SSAP 20 by recognising gains on unsettled transactions satisfies only one of these. Additionally a choice of using either the temporal or closing rate method does not allow consistency. Similarly the choice of accounting treatments of goodwill under SSAP 22 also is an example of inconsistency. Avoidance of such anomalies could occur as a result of a comprehensive framework.

J) Fine tuning of rules without involving the legislature

The ASC derived the authority to develop accounting standards from the CCAB, although the latter body had to approve these before they could be issued by professional bodies to their membership. Situations have arisen from time to time which cause standards to be amended. These may be

¹⁹ The reply to this question has been described as an overwhelming 'yes' (Davies, Paterson and Wilson, 1994).

because of loopholes in the original standards, by economic changes or by the need to reconcile standards with company law. From the 25 standards issued by the ASC seven have been withdrawn (two standards PSSAP 7 and SSAP 16 dealing with accounting for the effects of changing prices have been withdrawn, SSAP 11 has been replaced by SSAP 15 and SSAP's 6,10,14 and 23 have effectively been replaced by Financial Reporting Standards (FRS's) issued by the ASB). Of the remaining SSAP's extant as at December 1996, one standard has been amended or revised three times, 5 standards twice, 4 standards have been amended or revised once and the remaining 8 are as issued. Thus during the twenty years of the life of the ASC, the total of standards issued, withdrawn and changed is 42. During the same period, four Companies Acts have been passed.

Additionally accounting standards are reasonably flexible in their application which allows a certain degree of fine tuning to take place automatically. The explanatory forward to accounting standards states that in applying standards, it is necessary to have regard to the spirit and reasoning behind them (ASB 1991). Under company law, there is no obligation to use applicable standards in preparing accounts; all that has to be produced is a statement of compliance or non-compliance, and in the latter case a statement of the reasons and effect of this action. (CA 1989 7 sch.; CA 1985 4 sch. 336A)²⁰. The result however of such a statement may lead to investigations by the Financial Reporting Review Panel (FRRP).

K) A mechanism which raises and clarifies public debate upon which political decisions depend.

The debate on accounting standards arises through the way in which the ASC and ASB have proceeded with the development of new standards. As already quoted in this chapter, the ASC distributed 41,400 copies of ED 27 and 20,000 copies of ED 30. ED 27 received some 107 replies and was the subject of two public hearings. The debate was also carried on through the technical press. Between the issue of ED 21 (September 1977) and the end of 1978, Accountancy carried nine articles on the proposed foreign

²⁰ The result however, of such an action may be an investigation by the Financial reporting Review Panel (FRRP)

exchange standard. The public meetings and the opportunity to comment by letter, detailed earlier in this chapter and the fact that the debate is carried on through the press, is perhaps the reason why standard setters tend to have a higher profile than civil servants. Additionally, the publicity given to draft standards means that the procedures for carrying on the debate are better known whereas the mechanisms for the formulation of company law, may be less well known.

OTHER THEORIES OF AGENCIES

Both Hood (1978), Lewis (1985) and Thompson (1993) consider that agencies may be created in an attempt to conceal the real size of the bureaucracy. Certainly, a government wishing to do so, could offload tasks to an agency, although this would imply that the task is one which government considers that it ought to carry out but is organising the performance of this function in a more expedient way. Efficiency considerations were at the forefront of governmental thinking in the creation of 'next step' agencies following the Ibbs Report of 1988²¹. Hood describes this as 'the great bureaucratic disappearing trick'. According to Moran (1988), the reason for this could be either ideological or financial;

'To equip the Department or establish a free-standing regulatory commission would have required a substantial amount of money and staff by a government nominally hostile to an increase in public spending and public employment.' (p. 69)

Although in terms of members of the ASC (in 1985 there were 20 members), the number of individuals may seem low, this does hide the others involved in the process. As well as the research commissioned by the ASC (e.g. the study on 'The Accounting Treatment of Overseas Currencies - ASC 2/8/4), the necessity of receiving approval to the standard by the technical and research committees of the CCAB members would imply even more individuals were involved in the standard setting process. The workload of the ASC, already outlined in this paper

²¹ These agencies can be substantial in number with the Benefits Agency (65,000) staff employing twice the number of staff in several major government departments - see the Estates Gazette 1994.

points to considerable non-governmental resources being used in the development of accounting standards.

The growth of the number of agencies may also be seen as the multiplication of centres of power which indicates a move towards pluralism (Lewis, 1985). Self-regulation through agency use may also be an indication that the government does not wish to interfere in what it sees as important areas of the economy (Burch & Wood 1986). This does not appear to be a consistent government policy, as such areas as fair trading are kept within government departments, whereas the Stock Exchange is allowed to regulate its own affairs, a task which, according to Moran (1988), the DTI never wanted. Historically the role of government in accounting regulation was to ensure that necessary steps were taken for the protection of investors and creditors (Edey & Panitpakdi, 1956). With the exception of the 1981 Companies Act, there has been little stated in the law on such issues as income measurement or asset valuation which has been left to the accounting profession, and even those items included in CA 1981 were more as a result of compliance with the 4th Directive rather than being instigated by the UK government. Since the mid 1980's there has been a growth in self-regulatory agencies within the area of financial services²². The lack of governmental interference in the Stock Exchange and the passing of the Financial Services Act are examples of both passive and active support for private sector arrangements. If therefore capital and financial markets are best served through self-regulation, it may follow that accounting as a major decisional input to these markets is best arranged in the same way.

SUMMARY

There exist a number of different models of accounting regulation examples of which can be found throughout the industrialised nations. Where regulation takes place outside of government, the motives for agency creation are significant to the independence of an agency as they

²² For example the Self Regulatory Organisations (SRO's) recognised by the Securities and Investment Board. SRO's rules are considered by Moran(1988) to have the force of law and membership is legally obligatory. For a further description see Large (1993).

may indicate that the government accepts the rationale for their existence and may thus accept their independence.

The historical justifications for agency use do not appear to fit accounting regulators possibly because they represent former societal arrangements rather than modern functions and structures both in the public and private sectors. In the 1930's, agencies were fewer in number and tended to relate directly to the specific functions described by Jennings (1930) and summarised in Chapter 2. The privatisation of utility companies in the UK and the subsequent setting up of independent regulatory bodies is an example of the formation of new agencies as a response to a changed economic structure for an industry.

The Baldwin and McCrudden (1987) 'motives' were tested against both general and specific actions taken by the ASC. Although it appeared that there was a wide involvement in the process of accounting standard setting, this involvement may not have included all groups in society who would be affected by the regulations issued. Official Parliamentary questions gave the impression that action was being taken on certain matters by virtual delegation to the ASC (even though matters of accounting are rarely discussed in Parliament). This effective 'delegation' was most visible in areas where political dangers existed e.g. inflation accounting. The government avoided lobbying and requests for political favours by making the regulatory body the target for any action. No evidence could be found of external bodies trying to pressurise the DoT to change accounting standards (although no doubt lobbying does take place in respect of the consultative papers issued before any amendment to company law). The development of accounting standards almost exclusively used resources from the private sector, which avoided the work being undertaken by the DoT. Additionally, potential conflicts may have been avoided by the apparent consultation carried out especially in regard to SSAP 20. The ASC was by its nature an expert body which undertook a wide-ranging agenda which demanded administrative expertise. Although the ASC was often accused of being slow to respond, its actions were quicker than company law (the subsequent formation of the UITF under the reforms of 1990, introduced a rapid response to accounting problems). Similarly fine tuning of rules has been possible

through both amendments to standards and their flexibility of application. Agencies may be seen as working within an overall conceptual framework rather than in piecemeal fashion. Considerable resources have been used to develop such a conceptual framework, even though there still exists some inconsistencies within standards.

Although there would appear to be sufficient justification for the continued use of the private sector regulatory agency, there may exist factors which endanger the independence of the agency. Concealing the real size of the bureaucracy for example could be appealing to a government, both from the overload and the ideological viewpoint. The attraction of this is that if the agency can be controlled or at least influenced by the State, policy can be made and implemented at low or zero cost to the government. The move towards self-regulation would imply the government willingly withdrawing from a particular arena and reflects current developments in areas such as financial services, although no doubt there would be a limit to the scope and content of the decisions that the regulators could make.

Perhaps there exists a further motive for the State delegation of authority. The exercise of power without political accountability must be at times an appealing goal for governments. Certainly there are attempts by the government to influence the contents of accounting standards through replies to exposure drafts, and there have been recorded incidents of government 'threats' to regulators that issues would be incorporated into company law if not included in standards (Robson, 1988). This theme is further expanded in Chapter 8 which looks at the role of the government in relation to published accounts and again in Chapter 9 in the context of agency capture and iron triangle theories.

CHAPTER 4

AGENCY TASKS

INTRODUCTION

This chapter will examine both the specific function of the accounting regulators i.e. the development of accounting standards, as well as the general function of the use of expert bodies to work in the public interest.

The Pliatzky Report of 1980, referred to in Chapter 1, provided a functional classification of agencies, separating them into two administrative roles: executive and advisory. It would appear however that the ASC through its' regulatory role, had an executive function only and did not have an advisory role once a standard had been issued, any related guidance tending to come from the professional bodies.

'ASC does not comment on or interpret standards.'

letter from Desmond Wright (under secretary of
ASC) to Reads & Co, 6.2.87 - ASC 1/44/1

Thompson (1993) considers that executive functions incorporate a promotional role, which in the case of the ASC was carried out through actions taken to obtain acceptance of accounting standards, which according to Watts, Chairman of ASC (ASC 2/8/2) involved 'consent or persuasion'. The promotional role is implicit within the regulatory role in that the process of formulating standards incorporates the promotion of ideas by the regulators not only in their discussion and exposure drafts, but also in the other consultative actions taken.

COMPANY LAW AND ACCOUNTING STANDARDS

According to Self (1977), a condition of maximisation of agency independence is whether tasks can be treated in isolation from the rest of government. One approach to this question is to examine whether the task being undertaken duplicates the work of government insofar as formulating policy is concerned. This approach incorporates the economic consequences of accounting regulation which are examined in

Chapter 1 and further illustrated in Chapter 8. The second approach is to look at the specific areas in which both government and the private sectors operate.

Statutory information in an annual report and accounts is presented in both quantitative and qualitative forms consisting of the profit and loss account, the balance sheet, cash flow statement, notes to the accounts, the Directors report and the Audit report. Edey (1977) classified types of accounting standards into four areas, description, disclosure, presentation and measurement. These areas are not the exclusive domain of accounting standards, and examples of each type may be found within UK company law. The following table examines various 'topics' in accounting, and illustrates the presence of both law and standard setters pronouncements relating to each of these subjects.

Table 4.1 Subjects covered by standards and the law.

Subject	Companies Act	Accounting Standard
Going concern	1985 4 sch 10	SSAP 2
Consistency	1985 4 sch 11	"
Prudence	1985 4 sch 12	"
Accruals	1985 4 sch 13	"
Departure from		
Principles	1985 4 sch 15	"
Accounting Policies		
(general)	1985 4 sch 36A	"
Government Grants	1985 4 sch 28	SSAP 4
Depreciation	1985 4 sch 18	SSAP 12
Stock Valuation	1985 4 sch 27(1)-(2), sch 25, sch 26	SSAP 9
Goodwill	1985 4 sch 31(1)	SSAP 22
Investment Properties	1985 4 sch 32	SSAP 19
Development Costs	1985 4 sch 3(2)(c) and sch 20	SSAP13

Investments	1985	4 sch 84, sch 45(1) sch 45(2)	ED 55
Subsidiary Undertakings	1989	3 sch, 1 sch 10	FRS 2
Debtors	1985	4 sch format, note 5	SSAP 9
Related Party			
Transactions	1989	1 sch 9	FRS 8
Reserve Movements	1989	1 sch 10	FRS 3, SSAP 20
Revaluation Reserve	1989	1 sch 6	SSAP 19
Deferred Tax	1989	1 sch 8	SSAP 15
Dividends and			
Taxation	1985	4 sch 51(3)	SSAP 8
Pension Schemes	1985	4 sch 50(4)	SSAP 24
Contingent Liabilities	1985	4 sch 50(2)	SSAP 18
Post Balance Sheet			
Events	1985	7 sch 6(a)	SSAP 17
Extraordinary and			
Exceptional Items	1985	4 sch 57(2), 57(3)	FRS 3
Prior Year Adjustments	1985	4 sch 4(2)	FRS 3
Segmental Reporting	1985	4 sch 55(1)	SSAP 25
Income from Leases	1985	4 sch 53(5)	SSAP 21
Investment Income	1985	4 sch 53(4)	SSAP 8
Interest Payable	1985	4 sch 53(2)	SSAP 21
Operating Lease Rentals	1985	4 sch 53(6)	SSAP 21
Taxation Charge	1985	4 sch 54	SSAP 15
Group Accounts			
(Generally)	1989	Various Sections	FRS 2, FRS 6 FRS 7, SSAP 1
Format	1989	s 4	FRS 3

From the above list, it is difficult to describe the regulation of accounting as a task which can be treated in isolation from the rest of government.

It would appear that the only areas where accounting matters incorporated in the law are not supplemented by the standard setting body are the Director's Report, the publication of accounts and exemptions, the maintenance of company records and matters affecting capital and distributions. In the majority of other areas both sources of authority act, sometimes in a complementary manner, sometimes in conflict and on occasions duplicating requirements. In SSAP 9 'Accounting for Stock and Work in Progress', all three can be found, whereby the standard defines a classification of 'amounts recoverable on contracts' under the Companies Act general classification of debtors. Conflict appears in that the use of LIFO is permitted under the Act, but prohibited by SSAP 9¹. With the exception of this method, the general valuation rules and the disclosure requirements in respect of stock are similar.

EXPERTISE

Self (1977), considered that the more technical the content of the area covered by the regulatory agency, the more autonomy the agency was likely to possess, although he did not indicate how technical content is defined or indeed measured. A list of characteristics of professions, such as that produced by Perks (1993) may provide a standard against which degrees of technical content could be compared in that expertise is a feature of professions. These eight characteristics are 1) skill based on theoretical knowledge; accounting requires both skill and theory, in that there is a defined output from accounting, and that the practice of accounting is carried out under a (not always recognisable) theoretical framework; 2) professional association; the UK has six main accountancy bodies who control both entry to membership and the activities of members; 3) extensive period of education, although in the UK, possession of a recognised degree is not a requirement for student membership of all professional accounting bodies, it is becoming the norm. In addition to this some of these bodies require qualifying periods both before and after training and also continuing professional education;

¹ Although this produces an outdated figure for stock in times of rising prices, nevertheless, the Companies Act compensates for this by requiring disclosure of any material differences between the replacement cost or most recent purchase of stock and the book value. LIFO is used by some British companies e.g. Cookson Group plc, but is quite rare.

4) testing of competence; this is done through examinations set by the professional bodies. Although certain exemptions are available in the UK, these are generally limited when compared to the US for example; 5) Institutionalised training; before being allowed to use a designated title, UK accounting bodies require members to have practical and relevant experience; 5) licensing; members are licensed by their professional bodies. The value of this license is that it may allow the holder to utilise the monopoly conferred in respect of carrying out statutory audits; 6) code of professional conduct or ethics; all accounting institutes require a high level of professional behaviour from their members². This means that members of accounting bodies are liable to be disciplined or indeed excluded from membership. 7) self-regulation; not only has the management of 'internal matters' been the province of the accounting profession, but also accounting and auditing standards have been set predominantly by members of the profession and 8) legitimacy; this is achieved by the grant of a Royal Charter to each of the main accountancy bodies and by the audit monopoly conferred by company law.

SERVING THE PUBLIC INTEREST

Regulatory agencies have a clientele to serve (Self 1977), which is normally the group that will be protected by their regulations. The traditional view of regulatory agencies was that they protected society by positioning themselves in between unethical businessmen and corrupt politicians (Noll 1971). Lemak's (1985) ideal model of a regulatory agency based on the notion of fairness, describes procedures to restrain unethical behaviour in the private sector for according to Stigler (1971), 'regulation is instituted primarily for the protection and benefit of the public at large, or some large sub-class of the public', although Needham (1983) considers this to be 'implicitly assumed rather than explicitly documented'. Miles and Bhambri's (1983) 'regulatory activists' see their tasks (as members of the regulatory body) as representing the public interest.

² Ethics for an accountant or auditor may cover such diverse areas as confidentiality, obtaining professional work and fees. For a detailed summary of the ethics of the accountancy profession, see Maurice (1996).

Much of the theoretical (and indeed) the empirical work quoted refers to agencies set up to regulate trade or more especially public utilities. Although the publicity often attached to these types of agencies relates to pricing of services, this is not their sole responsibility. The quality of the service supplied and the dissemination of information may also be an obligation of the regulatory agency, but these functions can only be carried out and monitored if product and performance standards exist³. The regulations made are distributive as illustrated by the Office of Telecommunications (OFTEL), 1993, in their guide;

‘He (the Director General) must promote the interests of consumers, effective competition, efficiency by those providing services.... In carrying out this function, the Director General has to achieve the best balance as he sees it of these objectives.’ (Brackets added)

The public interest aspect of accounting regulation can be examined in terms of both producers and consumers, the former being the preparers of financial statements and the latter being the users. The regulation of accounting by the promulgation of accounting standards is a mechanism whereby the consumers of information (i.e. stakeholders) may be assured of the quality of that information. Since the introduction of the limited liability form of company by the 1855 Companies Act, regulation has been in place to protect these ‘consumers’, at that time thought to be only investors and creditors⁴. With the development of the stakeholder view of the firm, more users groups are now recognised⁵. It can be argued that the consumers of accounting information need the same protection as the consumers of other commodities. However as with other spheres of regulation, public interest is considered to incorporate efficiency. This would appear to have been acknowledged by the ASB in its Qualitative

³ For example Ofwat’s annual report for 1993 talks of ‘...the right quality service at the right price. There must also be scope for the companies to make progress on improving water quality and the aquatic environment’ p. 2.

⁴ Consumer protection also had the additional safeguards of the statutory appointment of auditors and the Prevention of Fraud Act. See for example Edwards (1989) and Edey and Panitpakdi (1956).

⁵ Chapter 6 expands on the theme of stakeholders in the context of accountability.

Characteristics Statement (1991), by recognising a cost-benefit trade-off in the production of information.

The term 'public interest' was in fact used in the original Constitution of the ASC;

'The Committee's objects shall be to define accounting concepts, to narrow differences of financial accounting and reporting treatment and to codify generally accepted best practice in the public interest'

but no definition was given of what was meant by this, and the term was changed to 'general interest' in the ASC 1982 Constitution but was not included in that of the ASB. In a written answer to a parliamentary question on 13th December 1989, John Redwood quoted directly from the 1982 constitution;

'...shall not regard themselves as delegates of sectional interests but shall be guided by the need to act in the general interests of the community and of the accountancy profession as a whole'

(Hansard, Vol 163)

In the United States, the situation is similar in that;

'... the standard setters are expected to represent the entire constituency as a whole and not be representatives of a specific constituency group.'

(Belkaoui, 1985)

Insofar as definitions of the public interest is concerned, these tend to represent some form of balance between consumers and producers. Noll (1971) defines public interest as the policies that the government would follow if it gave equal weight to the welfare of each member. However, in the context of regulation, he introduces a third dimension by discussing the balance between employees and owners of regulated firms and the purchasers of the services provided. Noll and Owen (1983) talk of advancing the interests of members of society in their roles as consumers, but doing so in a manner that promotes economic efficiency. Lemak (1985) synthesises public interest into the word 'fairness', meaning the balance between a reasonable return on investment for the producer and the receipt of quality products and services at fair prices for the consumers. All of these definitions appear to incorporate concepts of both equity and economic efficiency.

The wider public interest definition is also found in the United States where, the mission statement of the Financial Accounting Standards Board (FASB) states;

'The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors and users of financial information'

If the 'mixed' version of consumers and producers of information defines public interest, then in accounting terms, the interests of both the preparers and users need to be considered in the regulatory process. There would appear to be three possible ways in which the regulatory agency could satisfy this requirement. Firstly, the composition of and the voting powers of the members of the regulatory agency must reflect their constituents. Secondly, the agency must possess a clear definition of the term public interest and the way in which this can be satisfied. Finally, inputs to the regulatory process must be made by both preparers and users.

Membership

Details of membership in the early days of the ASSC and ASC are not easy to obtain. Individuals are often identifiable only from papers and minutes of meetings held in the ASC archives. The 1982 Constitution of the ASC provided for the reservation of up to five places out of twenty on the committee for users. In 1985, Taylor and Turley identified 4 user members of the ASC from their organisational backgrounds. The membership of the ASB as at October 1994 would only appear to contain one user whereas the 1991 Exposure Draft on Objectives of Financial Statements, like the Corporate Report (ASSC 1975), identified seven user groups, (although one group, the government may be said to be represented through its observer status).

Definition

The lack of definition of the term 'public interest' by the ASC was partly compensated by the The Corporate Report (1975), a document which emphasised users and the responsibility to them by preparers;

'Our basic approach has been that corporate reports should seek to satisfy, as far as possible, the information needs of users. We believe

there is an implicit responsibility to report incumbent on every economic entity whose size or format renders it significant. This responsibility arises from the custodial role played in the community by economic entities.' (ASSC, 1975 S 1.12)

Unfortunately the Report did not address the potential problems of conflicting information needs, whereby disclosure to one user group for example might harm the interests of another group, nor did it appear to recognise that public interest is formed from an array of different interests. In any case, the Corporate Report was never officially accepted as the objectives of, or as an official policy document of the ASSC. The ASB in its Statements of Principles overcame the problem of differing (but not competing) interests by concentrating on one group;

'As investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy. Awarding primacy to investors does not imply that other users are to be ignored. The information prepared for investors is useful as a frame of reference for other users, against which they can evaluate more specific information that they may obtain in their dealings with the enterprise.' (ASB, 1991 para 12)

It is perhaps difficult to either see this as either a definition of public interest or a statement of the way such interest might be satisfied. Certainly the arguments for a political economy of accounting put forward by Cooper & Sherer (1985) had identified this problem.

Inputs

The third way in which the public interest could be reflected in the work of an agency is through inputs to the regulatory process. These inputs exist in the form of comment letters received on Exposure Drafts. However, within the accounting domain, it is sometimes difficult to distinguish between preparers and users in the reply letters. Beresford (1993), cites examples of preparers presenting themselves to FASB as users⁶. In the case

⁶ Quoting examples of bank lending officers having been influenced by the preparer side of the bank in their comments. Indeed the Committee of London Clearing Banks describe themselves as both users and preparers in a comment letter dated 30.6.84 (ASC 1/7/4).

of ED 16, insofar as the foreign exchange provisions were concerned, only two respondents (Delta Group and Thompson Organisation) could be interpreted as acknowledging users; the former recognising difficulties for users, and the latter mentioning difficulties of comparability, which may be assumed to be a user-orientated comment. As all companies have a statutory obligation to prepare financial statements, it may be assumed that they also are preparer-orientated. Of the representative bodies, only the British Property Federation and the Committee of London Clearing Banks replied and both of these replies may have been from a preparer point of view.

In the case of ED 21, more companies seemed to acknowledge user needs. Out of the 45 company respondents, 9 mention users or comparability. Of the 7 representative bodies (Accounting bodies and the DTI having been excluded from the total), two, The Association of Investment Trust Companies and the Committee of London Clearing Banks, perhaps demonstrate their preparer orientation by requesting exemption from the standard in their comment letters. Insofar as individual comments are concerned, it is difficult to categorise these, as some are employed by other organisations and are expressing personal opinions and the types of comments received do not place the respondents in the category of either user or producer.

ED 27 received a similar number of responses from companies (46), but more (13) from representative bodies. Seven of these companies acknowledge in some way users through mentions of shareholder information, comparability or understandability. Insofar as the representative bodies are concerned, only two appear to represent users. One of these, the Society of Investment Analysts would appear to be a user by definition, and the other, The British Insurance Association, states its' interest both as a preparer and as a user for institutional investment purposes.

Generally, it has been assumed in the above analysis that the accounting profession tends to be more orientated towards preparers than users in that they are either preparing financial statements or auditing those statements prepared by clients (although on occasions they could be acting

as interpreters of information). Even where replies are received from users, Perks and Georgiou (1992) writing of FRS 1, believe that;

'...the Board is influenced more by the interests of *producers* than by the information requirements of *users*. An analysis of the responses to the draft standard shows that, amongst *users* of financial statements, most favoured the direct method; amongst *producers* of financial statements the overwhelming majority strongly objected to the direct method⁷ being required and argued that a choice between the two methods should be allowed.

Similarly, the large-scale exemptions for small companies, appear to result from pressure from producers against the proposals in the exposure draft' (p. 39)

Not only does there appear to be the problem of user inputs not being given sufficient weight in the process of standard setting, but the lack of interest by users, could compromise the achievement of a public interest orientation of standards. Beresford (1993) accounts for this by suggesting that users are not as well equipped or organised as other groups. This causes an imbalance in decision-making:

'Users are experts in what information would be most useful to them and why and the relative benefits of the Board's proposals in making capital allocation decisions. While other constituents and the Board, can only speculate about what would be most beneficial to users, only the users really know' (p. 73)

Beresford as Chairman of the Financial Accounting Standards Board also adds that a standard which pleases the largest number of replies to Exposure Drafts may not be consistent with the mission of the FASB.

SUMMARY

On matters of accounting detail, the tasks carried out by accounting regulators are in many instances not isolated from those of government. Examples were seen of items regulated both by accounting standards and the law, leading to pronouncements which were complementary, contradictory or identical. The tasks undertaken may be seen as highly

⁷ By requiring a summary of receipts and payments made, this method brings information to users that would not be otherwise available.

technical and carried out by professionals who are rigorously trained and licensed and Self (1977) would therefore see them as likely to be more autonomous through this particular characteristic.

The general function of a regulatory agency was seen as serving the public interest, and most general definitions of this term included the interests of both consumers (users) and producers (preparers). The three elements of how this might be achieved were examined. The membership of the regulatory bodies did not appear to have been representative of the body they might be assumed to serve (i.e. the information users) It appears that users are not now, nor have been in the past, well represented on standard setting bodies. The term 'public interest' does not appear to have been defined even when used by the ASC. If accounting like many other fields can contain conflicting goals, the solution might only be in the achievement of some form of interpersonal utility orderings to achieve a non-dictatorial social welfare ordering (Boadway & Bruce, 1984). The solution used by the ASB at present would appear to deny the existence of conflicting aims through emphasising the one user group, whose requirements it considers sufficient to cover all other groups. Finally, it was seen that users appear to have very little input into the regulatory process, which, if they do have differing information requirements, would imply that public interest, from the viewpoint of the information requirements of each group, is not being achieved.

CHAPTER 5

AGENCY FUNDING AND PERSONNEL

FUNDING

Agencies may be funded in a variety of ways. There are those which have been hived off from government departments and are usually financed entirely from those Departments' budgets e.g. Benefits Agency, and those agencies set up by a particular profession to regulate part or all of its activities; e.g. the early period of the ASSC which was financed totally by the ICAEW. Some agencies are financed in accordance with Stoker's (1990) definition of quangos as;

'...organisations that involve voluntary and private enterprise resources but which nevertheless receive public funding.....'

(p. 127)

although some financing structures cannot be so easily categorised; they would appear to be government financed, but with the government acting purely as an intermediary, imposing a levy on the particular industry and then passing this over to the regulatory agency as in the case of the UK utility companies¹. Such action would appear to insulate the regulators from the regulated although even if the provision of finance is guaranteed by statute, it could lead to the regulators being dependent on the government and thus acting almost as a branch of the executive.

Both the ASSC and the ASC were totally funded by the accounting profession. The formula for the cost-sharing did change from a pro-rata system according to the number of places occupied on the ASSC (ASC 4/3/2), to one based on the membership of the professional bodies. This was put forward in the proposals for amendment of the ASC constitution in 1982.

¹ In this way, these agencies are effectively 100% financed by the industry which they are regulating without being directly dependent upon them.

' This would be an appropriate time to align the method of ASC funding with that of all other CCAB committees i.e. the six governing bodies would be asked to share the costs pro-rata to the size of their memberships.' (ASC 5/3/5)

All financial resources from 1969 to the date of the commencement of the ASB were supplied by the professional accounting bodies mainly through the CCAB although physical resources were also supplied (albeit on a different basis which will be examined later in this chapter). Howlin & Skerratt (1992) describe how committees of the ICAEW served the ASSC in its early life. These committees included the Technical Committee, the Parliamentary and Law Committee, and the Technical and Research Committee who produced papers directly for consideration by the ASSC. Meetings were held at Chartered Accountants' Hall, the headquarters of the ICAEW and evidence exists of ASSC agendas being sent out on Institute headed paper² in 1970 (ASC 4/1/1). The 1976 Constitution of the ASC stated that the ICAEW Technical Directorate should assist the Staff Committee (ASC 4/7/5), although by 1983 it would appear that assistance to the committee was to be paid for from the ASC budget (ASC 4/7/5), and in a note for new members in 1987, the secretary and three under-secretaries of the ASC were all described as Chartered Accountants based at Chartered Accountants' Hall (their costs being paid for by the ASC). The note also explained that all meetings were held at the Chartered Association of Certified Accountants at Lincoln's Inn Fields³. (ASC 5/3/6).

It was not only the direct financial and other physical resources from CCAB members which supported the work of the ASC, but also professional firms. During 1989 for example, meetings of the ASC Planning Sub-Committee were usually held at the offices of Peat, Marwick, McLintock in London. (ASC 1/41/2). Previously, a series of informal meetings had been carried out during 1985 with professional firms, to review all accounting standards in the light of the 1985 Companies Act

² The later introduction of ASSC headed paper was a move to give the Committee greater impact in sending out letters to third parties (Telephone conversation in 1995 with J Winters, former ASSC under secretary).

³ This was said to be a move by Ian Hay Davison to placate ACCA who were questioning the costs they were paying for so little public credit (Winters, see above).

(ASC 1/75/2). Co-opted members of project panels (working parties), reporting directly to the ASC were voluntary providers of their services. Additionally, membership of the ASSC and the ASC was an unpaid position⁴. Until 1982 all Committee members were also members of CCAB bodies with an emphasis on those working within the profession. The effective cost of this membership was paid by the employer organisation representing a significant contribution in view of the generally senior nature of the individuals involved. Even after 1982 the majority of the committee were still members of CCAB bodies.

In the case of the Financial Reporting Council and the Accounting Standards Board, they are both empowered by their Memorandum and Articles of Association

'to seek and accept grants and funding of any description from any government, state, authority, body or person in connection with the exercise by the Company of any of its functions or powers, including (any) grants made pursuant to section 256 (3) of the Companies Act 1985 or any modification or re-enactment thereof.'

(FRC (ii) (f), ASB 3 [c])

The actual funding of the FRC is on a voluntary, but pre-agreed basis with the major sponsors⁵. All funds are paid to the FRC which is then responsible for disbursing these where necessary to the ASB and the FRRP (Financial Reporting Review Panel). The proportions paid are as follows:

Table 5.1 Funding structure of the FRC.

1/3	Department of Trade and Industry
1/3	CCAB bodies
1/3	Institutions

⁴ The major firms (who were represented on the ASSC/ASC), also pledged the support of their growing technical departments (Winters, see previous footnotes).

⁵ There were difficulties encountered in agreeing the funding and Accountancy describes 'months of argument between the DTI and the accountancy profession over who is to pay for the new system' (Accountancy, 1989 p9).

The third category consists of the following;

3/4 The Stock Exchange

1/8 British Bankers Association

1/8 Association of British Insurers, National Association of Pension Funds, Association of Investment Trust Companies, Association of Unit Trust Investment Funds.

The original report of the Review Committee looking into the proposed changes to accounting standard setting in 1987 (Dearing), recommended the following structure for contributions;

' Adequate funding should be provided by a levy on the filing of all company annual returns; by seeking contributions from the financial community, including the Stock Exchange; by the sale of literature on standards and decisions on emerging issues; by a continuation or modest increase of present levels of funding from the profession; and through arrangements for public sector bodies to contribute on a scale matching that of private sector entities of comparable size.'

(Dearing, 1988 R15)

The levy on filing suggested by the Report was £1 per company which it estimated would raise £700,000 or about one half of the proposed level of expenditure. In 1989, the Department of Trade and Industry produced a consultative document based on the Dearing Report in which they expressed their opinion that companies should make a small contribution to the cost of setting and enforcing standards and suggested that the fees paid by companies should be set at a level which would finance a government contribution of a third of the cost. The reason for the reduction in the proportion was given in the same document.

' We think that the contribution made in this way should be well under half the total so as to avoid giving the Government too influential a voice in comparison with other interested parties.'

(Paragraph 18)

Although this was stated openly at the time by the DTI, nevertheless they would appear to refute any link between the increase in filing fees for

companies (from £20 p a to £32 p a) and the contributions paid to the FRC⁶. This might suggest that the DTI are claiming more credit for funding the FRC than is actually the case. Ultimately the Stock Exchange contribution was made by means of a levy on listed companies.

By comparison, in the United States, the financing of FASB is carried out through the Financial Accounting Foundation (FAF). As this is set up as a non-profit organisation income is exempt from taxation, and donations are deductible as charitable contributions on the donors tax returns. The contributions to FASB were as follows in 1993:

Table 5.2 Funding structure of FAF

Public Accounting Profession	\$3,337,000
Banks, Industry, investment firms and other supporters	\$3,190,000

Source - F A F Annual Report 1993

All such contributions to the Board are made on a voluntary basis⁷. However, there are no contributions made by either federal or state governments (although the latter contribute to the Government Accounting Standards Board).

One of Self's (1977) conditions for maximising agency independence is the existence of an adequate and independent source of revenue. Adequate is a somewhat subjective concept and although comparing budgets of standard setting bodies is possible, this may hide differing functions and environments. The maximum budget of the ASC was £526,000 in its final year of operation (ASC 1/41/2), but this sum did not include premises which were supplied, as far as can be ascertained, by CCAB member bodies, or the time of Committee members which was unpaid. Neither of Self's maximising conditions appear to have been satisfied in that revenue does

⁶ Telephone conversation with R Coker, assistant company secretary of FRC on 10.1.95.

⁷ The writer could find no evidence of conflict over the funding of FASB, although undoubtedly there would exist the incentive for all the contributors to become 'free riders'.

not appear to have covered costs and the source of that revenue was the representative bodies of those being regulated.

The supply of such 'free' resources as premises, personnel and expenses is also commented on by Mitnik (1980) who discusses industry control over its regulatory authority, observing;

'By doing the regulators "favors" and satisfying everyday job performance needs through supplying information, the industry can ease regulators' work loads (i.e., increase their level of "convenience") and create friendships between industry members and agency personnel' (p. 211)

The review of accounting standards carried out by professional firms and quoted earlier in this chapter is an example of such a favour which would have reduced the workload of the ASC.

PERSONNEL

The significance of the personnel of a regulatory agency would appear to relate mainly to their backgrounds, although some writers consider that staff only represent one of a broad range of factors affecting agency behaviour (Moe, 1985). Reagan (1987) quotes studies from Katzmman, Kelman, Quirk and Rabkin, in support of the proposition that professional norms contain value elements as well as technical ability⁸. On the other hand, Grant & Marsh (1977) consider the common background argument somewhat dubious on the grounds that this facilitates contact rather than creating influence. These apparent contradictions are in some ways reconciled by Lemak (1985), who talks of the interaction of the regulators and the regulated as a form of agency capture. It is not therefore simply the sharing of norms which leads to influence, but also perhaps the contacts both social and institutional (through professional associations) which bring about influence.

⁸ In the UK, the term 'social closure' is often used to describe the value elements (Jones, 1995).

From an analysis of the background of members of accounting regulatory bodies, it would appear that there is a high degree of commonality both in professional training and backgrounds. In 1987, for example, the seven member Board of FASB contained six CPA's (Certified Public Accountants), four of whom had practising experience with some of the largest international accounting firms, while the others consisted of an ex treasurer of IBM, a director of auditing and accounting with a regional public accounting firm and one academic. Although it is a requirement of FASB that all Board Members sever their relationships with previous employers, six of the members had undergone the same training and had probably acted more as preparers than users of financial statements. By 1995, the composition had changed to only five CPA's, the other two members coming from academia and the securities industry. Nevertheless, the majority voting system could mean dominance by those with a background in big industry and large accounting firms.

An analysis of the members of the ASC between 1978 and 1987, shows some changes in the background of members following the new ASC constitution of 1982. Up until that date, all members of the ASC were also members of CCAB bodies, reflecting the allocation of seats between the professional associations (with the ICAEW having the right to appoint 12 out of 23 members). From 1982 to 1987 two members of the ASC were not members of CCAB bodies. Despite the 1982 Constitution providing for up to 5 of the 20 places being reserved for users of financial accounts, there did not appear to be a significant shift from industry and practice members to representatives of other organisations during this period.

In the following analysis of the background of members of the ASC, the 'Others' category include those who are not apparently preparers or auditors of financial statements⁹, including representatives of Local Authorities, Nationalised Industries, Lloyds, The Stock Exchange and academics. This latter category had always been members of the ASSC/ASC since 1969, and from that date until 1990, there had been four

⁹ For example, the 30.11.82 membership list included representatives of University of Reading, British Railways Board, The Stock Exchange, the Government Accountancy Service and Somerset County Council.

members (Edey, Bromwich, Gray and Nobes), and the ASC had issued a working paper in July 1988 on the establishment of closer links with the academic community. By 1990, there were some nine academics serving as members of or advisers to the ASC and its working parties (ASC 1/76/2). Those members in practice tended to be partners in larger firms of accountants, while the industry members held senior positions in major companies in the UK.

Table 5.3 Analysis of ASC members 1978-1987.

Date	<u>ASC</u>	<u>CCAB</u>	<u>ICAEW</u>	<u>Industry/</u>	<u>Others</u>
	<u>Members</u>			<u>Practice</u>	
30.11.78	23	23	12	18	5
30.11.79	22	22	12	17	5
30.11.80	22	22	11	16	6
30.11.81	22	22	11	16	6
23.3.82	23	23	12	16	6
30.11.82	20	18	9	15	5
30.11.83	20	18	8	14	6
1.9.84	20	18	8	15	5
1.9.85	20	18	8	15	5
1.9.86	20	18	8	15	5
1.9.87	21	19	9	14	6*

* includes 2 members with no apparent industrial/professional connections.

Insofar as working parties were concerned, there appeared to be no constitutional arrangements as regards their composition. Some working parties such as that formed to consider ED 16 and that for price level accounting, consisted totally of ASC members. Certain others, such as the working parties for pension costs and goodwill, had no current ASC members. The appointment of working parties was for some time the task of the planning sub-committee (ASC 2/49/3), although there may have

been alternative and less formal mechanisms in place. Renshall was asked by Watts, ASC chairman to lead the working party on goodwill (2/24/1). Towards the end of the ASC's life, Wright, the under-secretary, wrote to the Technical Director of ICAEW asking for names of people willing to serve on two new working parties (ASC 5/3/1). Previously, Arthur Young were asked to nominate a member of the working party on goodwill (ASC 2/61/2) and Holgate, ASC under secretary in 1985, wrote to brokers and companies for suggestions for working party candidates (ASC 5/3/3). From the above, there appears to have been no system or criteria indicated for the selection of candidates. The only common factor relating to members of the working parties, was that they were almost exclusively the domain of members of CCAB bodies. Their relevance to the exercise of power in the regulatory context is difficult to quantify although there exist many examples of working parties being over-ruled by the ASC.

Not only may the identity of accounting regulators be significant, but also their method of appointment i.e. are they appointed by those they are seeking to regulate or by those on whose behalf they will be acting. In the United States, Reagan (1987) describes how attempts were made to make regulatory commissions more accountable through strengthening the President's power to appoint and remove the chairmen of these commissions. The result of this has led to a reduction rather than an increase in the independence of commissions in the opinion of Welborn (1977);

'through the position of chairman, the regulatory agencies stand in relatively close association with the executive branch in various important respects, rather than being truly independent of it'

(p. 141)

This is somewhat in opposition to the theories of agency capture by the regulated industry which are examined in Chapter 9, although the two views can be reconciled by the fact that the appointment to a specialist agency may have to draw on the only source of available technical expertise i.e. the industry being regulated. This is the justification given by Reagan for so many regulators having a background inside the industry. An alternative analysis might be provided by ascertaining whether regulators are appointed on the basis of their close association with governmental thinking or their perceived independence.

The appointment of all Board members of FASB, a non-governmental agency, rests with the Financial Accounting Foundation (FAF)¹⁰. Miller and Redding (1988) consider it theoretically possible that a Board member might modify a position on an issue to ensure re-appointment, although they claim that there is no evidence that this has ever occurred. They identify the greatest threat to independence arising if a particular group (preparers) were to gain control of the FAF Board of Trustees, although they talk of this in terms of it being highly improbable. Belkaoui (1985) however illustrates the control over the US standard setting process by the 'big eight'. This occurs through the control by the 'big eight' of the AICPA whose Board of Directors have exclusive authority to elect and remove the members of the FAF Board of Trustees. If therefore the major accountancy firms are considered preparers rather than users, the hypothetical case described by Miller and Reading (1988) represents reality.

The ASSC being a committee of the ICAEW had its officers appointed by the Institute President. Amendments of its constitution in 1970, 1971 and 1975/76 brought in other CCAB bodies, each with a fixed number of places. Each of the members was appointed by their own professional body. The revision of the ASSC constitution in 1976 stated in Paragraph 2c) that 'The Chairman and Vice-Chairman would be appointed by the Chairman of CCAB on the recommendation of ASSC....' Howlin and Skerratt (1992) describe how under the new ASC constitution of 1982, a Nominations Committee was set up consisting of a representative of each of the CCAB bodies and the ASC chairman. This appears to be evidenced by a letter from W Hyde (who had ceased to be a member of the ASC in 1979) to the President of CCAB dated 5.8.82 stating;

' In formulating our recommended list of members we have taken careful note of the need to ensure appropriate representation, balance, continuity and rotation and to provide for these for the future...'

(ASC 5/3/5)

This was presumably written in his capacity as ICMA representative on the Nominations Committee. The Nominations Committee lapsed

¹⁰ The Financial Accounting Foundation acts in many ways like the FRC in the UK and as well as having the power of appointments, they are also responsible for funding and overseeing the work of FASB.

between 1982 and 1989 with appointments being made by CCAB office-holders, consulting with the ASC chairman where appropriate (Howlin & Skerratt 1993). The 1983 Constitution of the ASC had contained the provision in paragraph 12 that the power of appointment of members was vested in the CCAB. In 1986, the ASC revisited its 1981 document 'Setting Accounting Standards' and noted that CCAB bodies had retained effective control of membership matters with only one non-accountant and only three users on the Committee (ASC 1/41/2). Prior to this, the notes of a meeting of ICAEW office holders in 1985 reported that;

'Brian Jenkins indicated that the CCAB meeting on 4th November would be discussing the Vice-Chairmanship of the ASC. He said they would also discuss who should be the new Chairman....'

(ASC 1/48/4)

This right of appointment appears to have been written into the Shareholders Agreement of the CCAB dated 19.2.86 when it was reconstituted as a limited company. The Agreement provided that 'The Bodies shall procure that the Board shall appoint a Chairman and a Vice Chairman of ASC for a term of up to three years' (ASC 3/8/4). A letter from Renshall (then Chairman of ASC) to E Warne (secretary of CCAB) dated 14th February 1989 stated 'I would like to see greater representation from non-accountants' (ASC 5/3/1), although, he continued in the same letter 'As you know, the Chairman of CCAB has asked me to advise on the rotation and replacement of members of ASC.' Appointment of new members of all three CCAB committees was established under Clause 4 of the amended CCAB constitution dated 6.2.89. Throughout the lifetime of the ASC the power of appointments had shifted from the professional bodies to the CCAB.

The formation of the ASB shifted this power away from the accounting profession. As an incorporated company, the ASB has its' procedural arrangements stated in its Articles of Association and paragraph 34 (b) and (c) grants powers of appointment, re-appointment and removal from office to the Appointments Committee whose powers also extend to the office of Chairman, Vice Chairman or Technical Director. Paragraph 1 of the Articles interpret the Appointments Committee as;

'...the board of directors as constituted from time to time of The Financial Reporting Council Limited and any 3 other members of

the Council of The Financial Reporting Council Limited whom the directors of the Financial Reporting Council Limited may nominate for this purpose from time to time'.

The Board of Directors of the Financial Reporting Council cannot exceed four in number¹¹ (FRC Memorandum and Articles of Association, paragraph 23 {a}) and the power of appointment and removal (including the chairman) rest with the Secretary of State for Trade and Industry and the Governor of the Bank of England (paragraph 23 {b}) or their duly authorised representatives.¹² Guidelines are however given to the two appointees of the desirability of directors including

A) a member of the CCAB or with experience relevant to the interests of the accountancy profession,

B) a member of the Council of the International Stock Exchange or with experience relevant to the carrying on of financial activities.

C) a member of the governing body of the Confederation of British Industry or with experience relevant to the interests of industry and commerce
(paragraph 23 (c) 1-3)

The Council of the FRC may have up to 30 members who are appointed by the directors of FRC Ltd. Apart from the directors themselves, there are four reserved places. One government representative appointed by the Secretary of State for Trade and Industry, one representative of the Bank of England, appointed by the Governor, plus the Chairman of the ASB and of the Review Panel, both acting ex-officio. The additional members should be members of the accountancy profession in either the public or private sector and users in order to secure;

¹¹ As at 31.12.96, the Directors were Sir S Lipworth, Deputy Chairman of Natwest Bank Plc; J Kemp-Welch, Chairman of the Stock Exchange; B Currie, Chairman of CCAB and President of ICAEW; and Sir C Marshall, Chairman of British Airways Plc.

¹² This is basically the same institutional arrangements that exists for the Securities and Investment Board (SIB). Other regulatory bodies such as the Health and Safety Commission have members appointed by the Secretary of State for Employment after consultation with representative bodies.

'...a proper balance between the interests of persons engaged in the preparation of accounts and those engaged in reporting on accounts and of the public.' (FRC Mem and Arts paragraph 4[1][f][2])

The function of the Council given by the Memorandum and Articles of Association is to;

'...determine the general policy of the Company in relation to the attainment of its objects, and to formulate the general nature of the guidance and advice to be given from time to time by the Company to such companies or other bodies as it may establish or support for that purpose'. (para 42 [1])

Wilson (1980), in his study of the behaviour of regulatory agencies, identified in the case of governmental agencies three types of employees. The first type he identifies, politicians, does not apply directly in the case of accounting regulation. Politicians are features of government agencies especially in the United States as they "see themselves as having a future in elective or appointive office outside the agency.' (p. 374). It is not easy to relate these to UK agencies. His second type, careerists, who are described as 'employees who identify their careers and rewards with the agency' (p. 374) did not exist in the ASC because the mainly voluntary nature of the work precluded such a structure, and it is probably too early in the life of the ASB to identify any careerists. The terms of office of Board members of FASB is limited to two terms of five years. Project managers may however remain longer with FASB and can be promoted to that position, although no research appears to have been carried out relating to these employees. Additionally industry fellows are appointed for two year periods usually on secondment from Big Eight firms (Miller & Redding, 1988).

Professionals are the third type, seeking either a 'stepping stone' to a better career or remaining with the agency for the maintenance of their professional esteem. Reagan (1987) considers that a significant input to regulatory behaviour is caused by the factor that he refers to as the 'revolving-door', that is a tendency for regulators who come from the regulated industries to see things from the industry viewpoint, and to have a strong incentive to please the leaders of the industry they are

regulating, in the hopes of moving into good private sector positions¹³. The analysis of members of the ASC in this chapter illustrates that the majority were all simultaneously holding senior private sector positions while working as regulators. It would seem unlikely that actions taken when acting as regulators would damage their private sector employers (or clients). Equally, it might be assumed that the 'correct' actions taken within the regulatory arena might assist their careers.

The formation of the Accounting Standards Board in 1990, saw the introduction of a full-time Chairman and Technical Director. To date (April 1997), there have been no changes in these office holders. By contrast, of the original seven (part-time) members of the Board appointed in 1990, none still were members at the end of 1996¹⁴. As the members in professional practice between both these years were either partners or holding senior positions and the industrial members were all of Director level within large public companies, it is perhaps difficult to estimate the benefits they would receive from membership in terms of career enhancement.

Although the writer could find no analysis carried out, it would, in the case of FASB, not be unreasonable to assume that Board members on expiry of their term of office returned to the profession, possibly with enhanced reputations. This is more accentuated in the case of practice fellows who are usually seconded from the 'Big Eight' firms and as Miller & Redding (1988) explain;

'This dominance is not planned, but merely reflects the facts that a larger firm is more capable of absorbing the loss of the fellow's services for two years and of using the special knowledge that he or she gains at the FASB.....Virtually all fellows have been promoted to partner after their service, and some have continued to

¹³ Although in his US study, he did not consider that the correlation between a regulated industries' source of personnel and the pro-industry orientation of decisions was any greater in the independent regulatory agencies than in the 'line agencies'.

¹⁴ The closest example of continuous service is Professor Whittington, who was originally the academic advisor in 1990 before becoming a board member.

work with the Board as representatives or spokespersons for their firms.'

(p. 46)

SUMMARY

The significance of funding and personnel has long been recognised, with TR 549 issued in 1984, stating 'It should be born in mind that the volume of work undertaken by the ASC is determined by the governing bodies through their decisions on the ASC's budget and level of staffing.' Not only is it the volume of work that is affected. Reagan (1987), in his study of US regulatory agencies classifies both budgetary control and the power of appointment as always having been limitations of agency independence. The ASSC and the ASC were supplied with all financial resources from the accounting profession and other resources in terms of personnel and offices were supplied almost exclusively from the same source. The FRC/ASB funding appears to follow closely the model of FAF/FASB with voluntary funding from a wider variety of sources.

All the accounting regulatory bodies examined in this chapter demonstrate a close identification with the accounting profession, although from 1982 onwards there was an attempt in the UK to move away from the emphasis on members of recognised accountancy bodies, who were also preparers¹⁵. The prevalence of qualified accountants however is felt to be an inevitable function of the tasks involved in accounting regulation¹⁶. The UK has moved away from the US model of appointments by involving a wider constituency in the process although ultimate control of those responsible for making the appointments now rests with the government. This is more in line with the more general UK and US model of regulatory agencies (although in the US such appointments are Presidential). FASB though, as a non-governmental

¹⁵ The ICSA (Institute of Chartered Secretaries and Administrators) had expressed doubts by considering that widening the membership of the ASC was nullified by the fact that standards were still issued by the CCAB. (ASC 2/53/2).

¹⁶ Noll (1971) preferred the idea that non-political (and non-business), neutral individuals could be appointed to agencies, who over the years could become expert enough to detect the most socially desirable policies.

agency still appears to have its appointments system dominated by the accounting profession.

Insofar as the 'revolving door' is concerned there is a little evidence from the US of this occurring, although such a phenomena was not applicable in the early UK days of standard setting as the regulators were simultaneously employed by industry and the professions. However, this may be seen in the future in the case of the ASB, with the introduction of full-time board members and project managers.

CHAPTER 6

ACCOUNTABILITY

INTRODUCTION

The final characteristics suggested by Chapter 2 as affecting the independence of regulatory agencies are structure and process. The structure of an organisation may create accountability through the way in which the organisation is constituted. The particular significance of this characteristic is that the term is often used synonymously with control (Baldwin and McCrudden, 1987). Accountability also implies that decisions and actions are made public to third parties, which can impact upon the processes adopted by the agency (if not the decisions themselves).

Traditional concepts of accountability suffer from the problem outlined in Chapter 1 which described 'constitutional awkwardness'. As a response to the more complex environment of government departments, government agencies and private sector agencies, new concepts of accountability have been developed. This chapter commences with an examination of these new concepts¹, before testing their applicability to accounting standard setting bodies, in order to examine whether lack of traditional accountability has been overcome by an alternative form or forms.

Given the nature of accountability (explored later in this chapter), an examination of any organisation would appear to be capable only of identification rather than the measurement² of this characteristic. Within both the political and corporate settings in which the relevant theories

¹ These new concepts have been developed and tested mainly in the area of government.

Other concepts arise from studies of companies. These are however relevant to this study in that both are examples of complex organisations with responsibilities to outside parties. Additionally, jointly they help create the arena in which accounting is practiced.

² For instance, the Joint Committee of Public Accounts has stated 'Accountability cannot be measured like the amount of water in a glass' (see Parliament House 1989)

have been developed, there exist a principal/agent relationship, underpinning the need for accountability to be present, although this relationship is used in a different way to the traditional economics approach as will be seen later in this chapter. Successive studies suggest that accounting information (and therefore it's regulation) is a public good produced for society at large³. Thus accounting regulators, situated within a principal/agent relationship must be accountable to society on a periodic basis, for, as Shocker and Sethi (1973) conclude;

'In a dynamic society, neither the sources of institutional power nor the needs for it's services are permanent. Therefore an institution must constantly meet the twin tests of legitimacy and relevance by demonstrating that society requires it's services and that the groups benefiting from it's rewards have society's approval'.
(p. 105)

For accountability to exist within the principal/agent relationship, four pre-requisites have been identified by Rose (1985). This chapter then examines these pre-requisites, both on a theoretical basis, as well as relating them to accounting standard setting bodies.

NEW CONCEPTS OF ACCOUNTABILITY

Smith (1981) writing in a government setting, recognises that the actions of agencies should reflect popular choices as interpreted by elected representatives, whose role is to monitor actions as well as make decisions. However, state activity has become more diverse, whilst developments have occurred in the machinery of government and in administrative processes, meaning that the traditional concept of political accountability can no longer be applied⁴. The growth of what Smith (1981) describes as 'a bewildering array of executive, regulatory, investigatory, commercial, advisory and judicial bodies' (p 1164)⁵, has meant that new and sometimes conflicting concepts of accountability have emerged to

³ Conceptual framework projects outlined in earlier chapters have recognised all members of society as users with rights to accounting information.

⁴ in the simple form described by Birch (1964).

⁵ See also Holland & Fallon (1979).

supplement and sometimes replace the traditional constitutionally-based concept. He identifies these concepts of accountability as follows:

- | | |
|------------------|-----------------|
| * Constitutional | * Economic |
| * Judicial | * Commercial |
| * Quasi-Judicial | * Professional |
| * Procedural | * Decentralised |
| * Consultative | |

This chapter will next examine each of these concepts for their impact on the accountability of any non-governmental body in order to test their possible application to private sector accounting standard setting (and other regulatory) bodies. Theories and concepts developed mainly within the area of political science are used because regulation (and enforcement) are functions which have traditionally been carried out by Government Departments and Government Agencies.

Constitutional Accountability

Under constitutional accountability, the responsibility of Ministers or of the government as a whole is to an elected assembly (Birch 1964). Traditionally in the UK, the head of any government department, the Minister or Secretary of State is a political appointment, and therefore answerable to the nation's elected representatives for actions taken by himself or any of his officials, such officials being protected personally from political criticism or censure. Responsibilities of these political appointees include not only the proper spending of funds, but also efficiency considerations such as achieving value for money. Procedures have to be adhered to in order to ensure that the department is defensible in terms of its activities. This may result in an impact upon operations, causing delays and rigidity, sometimes leading to friction causing a trade-off between efficiency and accountability being made. Smith (1981) describes how the recruitment of senior government employees through open examinations implies the impartiality of their appointments, with any praise or blame for their actions being attributable to the political heads of departments rather than these officials. Their work is also characterised by anonymity, which focuses even more responsibility for

departmental actions on the political heads, although these conventions are changing.

The implication of constitutional accountability for executive departments is that there is one identifiable individual who carries the responsibility for any actions taken by that department. Actions are strictly defined by function and carried out by an impartial and anonymous staff. Responsibility of a government department is to the elected assembly and involves financial and decisional aspects, both of which are capable of being monitored. Where an agency is used, there may be a sponsoring department as in the UK example of the Contributions Agency and the Benefits Agency and their relationship with the Department of Social Security. Not only does the work of those agencies serve the department directly, but there is a historical link in that their work was originally carried out by the department. In this type of situation, the responsibility of the Secretary of State for the work of the agency is not clear⁶. By contrast, some regulatory agencies do not have the same historical or practical connection with a government department, and this lack of 'sponsorship' may also distance them from constitutional accountability.

This is the case of the ASC which owes its origins in part to a desire to avoid the involvement of the state in matters of accounting detail. By contrast, the US standard setting body derives its authority from the Securities and Exchange Commission (Miller & Redding 1988), a federal regulatory agency with statutory authority for financial reporting by quoted companies. The fact that the five Commissioners are all appointed by the President, would tend to signify some level of constitutional accountability, examples of which were illustrated in Chapter 1 through political interference with proposed accounting standards. If accounting were regulated only by the state as is the case of some European countries (see Nobes & Parker 1995), then it would be easier to trace constitutional accountability, as accounting could be viewed in the same way as any other policy area. The UK government has always tended to distance itself publicly from accounting detail, as seen in the Parliamentary replies

⁶ The dismissal of the Director of the Prison Service in 1996 is an example of the denial of responsibility by the political head of a government department.

quoted in Chapter 3. Although government agencies may still be subject to powers of direction by a minister or subject to the Parliamentary Commissioner for Administration, this is not the case for either the ASC or ASB. Thus standard setting bodies are seen to be outside of the political structure, both by government as well as by themselves.

Judicial Accountability

The principle generated under judicial accountability is that decisions and actions of officials in government departments and agencies should be made in accordance with the law. Although non-departmental bodies may exercise a legal type of power, nevertheless they themselves are subject to the law, which has implications for their actions.

'The duty to obey the law, enforceable by action in the courts at the instigation of those affected by the actions of public bodies, imposes an obligation on a public body to explain and justify its actions in legal terms if sued in the courts'

(Oliver 1991 p. 26)

A department must not exceed its statutory responsibility but must do what it is obliged to do by statute, following prescribed procedures where applicable and must act without negligence, unreasonableness, bad faith or ulterior motive. Judicial review is one way in which this type of accountability can be achieved, and the department forced to behave in a proper manner. Oliver (1991) expands these responsibilities into the private sector.

'This duty (to ensure actions are lawful and that powers have been exercised fairly and rationally) extends to private bodies exercising public functions, such as professional organisations and regulatory bodies in the City of London'

(p. 26, brackets added)

The significance of judicial accountability rests upon the fact that the law is the highest form of authority with new laws and amendments to existing laws having to be approved by a legislature which is itself accountable to society in the form of the electorate. Other bodies may make binding rules and decisions, but these cannot replace existing laws and in many

instances draw their regulatory powers directly from the law itself⁷. Where the 'legality' of a decision made by a non-parliamentary body is queried by appeal to the law, then judgement has to be made on the basis of whether this contravenes an existing law and whether powers have been exercised reasonably following proscribed procedures.

Judicial accountability has the general criteria of the legality or illegality of actions. UK standard setters do not have statutory duties to perform; therefore they cannot exceed or fall short of statutory responsibilities and the question of illegality has been overcome in several ways. The Companies Act (1981) allowed departure from accounting principles (s15), as well as the use of the true and fair override.

The Opinions obtained by the ASC in 1983⁸ suggest a form of delegated authority by stating that compliance with accepted accounting principles was prima facie evidence that the accounts were true and fair and the fact that 'The function of the ASC is to formulate what it considers to be generally accepted accounting principles.' (Hoffman and Arden, 1983, para 9, 10), would imply such delegation. However, where conflict has occurred between accounting standards and the law, adjustments, effectively of a cosmetic nature have been made to reconcile differences⁹. Future standards however may avoid conflicts because of the way that the ASB;

'...must also consider the environment in which its' standards are to be applied. The legislation with which reporting entities must comply forms an important part of that environment. Accordingly, FRS's are drafted in the context of current legislation and European Community Directives with the aim of ensuring consistency between accounting standards and the law.'

(ASB 1993 para 34)

⁷ For example, the Office of Telecommunications (OFTEL) was set up under the Telecommunications Act 1984 and grants to that regulator 'extensive powers.... to determine the questions specified in a license, enforce the observance of license conditions or initiate modifications of license conditions' (OFTEL 1993).

⁸ from L Hoffman QC and M Arden QC.

⁹ see for example SSAP 9 which allows profit to be recognised on long term contracts by changing balance sheet and profit and loss account descriptions and treatments.

If this fails however, there is still the true and fair override!

In addition to this form of delegated authority enjoyed by the ASC, their successor has received within the 1989 Companies Act a more formal recognition of accounting standards. The Financial Reporting Review Panel (FRRP) acts as a quasi-court in deciding whether to attempt to force restatement of financial statements or indeed invoke other action¹⁰ where there are identified material departures from accounting standards which affect the true and fair view¹¹.

Quasi- Judicial Accountability

Quasi-judicial accountability does not have legality or illegality as one of its criteria. The law specifies certain statutory rights for individuals or groups, usually consisting of services, benefits or exemptions. Examples of these would be rights to receive pensions or social security payments. Decisions are not queried on the grounds that they are illegal, but rather that the individual has been dealt with under the wrong category. A feature of officials working within broad and perhaps vague statutory frameworks is that their discretion has to be controlled by codes of practice, departmental rules, guidelines and other instructions. Often in the UK, administrative tribunals¹² with limited legislative backing, are used to review cases and guide the exercise of discretion; the existence of such tribunals being a further check on the decisions of officials. The implications of quasi-judicial accountability are that under a general legal framework, where discretionary decisions are made, these have to be formally defended in terms of either content or procedures.

¹⁰ Edwin Glasgow, chairman of the Review Panel is quoted as saying 'resorting to litigation would be very much the last stand' (see Perrin, 1996)

¹¹ This does not necessarily include breaches of the Companies Act, although the policy of non-depreciation of certain properties by Forte Plc was contrary to both SSAP 12 and the Companies Act. This was accepted by the FRRP. The Panel has so far (to December 1996) examined 37 cases (see Accountancy, December 1996)

¹² Examples of these are found generally in the area of fiscal liability, property and land, social welfare and regulation/licencing. Specific examples from each category include the Lands tribunal, Mental health tribunal and Gaming Board tribunal.

Quasi-judicial accountability reflects delegated powers and the correct use of these powers. It could be argued that the power to make accounting standards is implicitly granted by the Companies Act to the ASB. However, no examples appear to have been recorded in the UK of objections to accounting standards on grounds of either misuse of powers or of procedural defects.

Procedural Accountability

Where defects in official conduct or administrative procedures cause hardship or injustice when applied to specific cases, then, although the decision made is legal, that decision may be thought of as unreasonable, due to the surrounding carelessness, inefficiency, incompetence, delay, ineptitude or arbitrariness. Procedural accountability is concerned with the operation of internal rules which are drawn up to control decision-making. Within government departments in the UK, these internal rules are subject to scrutiny by the legislature through use of the Parliamentary Commissioner (Ombudsman) whose recommendations although advisory, are generally taken very seriously by government departments. Other organisations use the notion of due process as a way of ensuring good (and fair) decision-making, as well as in the more defensive role of justifying that care has been taken. The term 'due process' can be used in several different settings to describe the steps used to assure careful consideration being given to an administrative process. Miller & Redding (1988) in the context of FASB, talk of due process embracing not only a systematic approach to problem-solving, but also the creation of an environment in which constituents and members of the business community can become involved. Thus in the face of external criticism, it can be shown that matters have been dealt with efficiently, fairly and without prejudice.

The ASC did not appear to use the term 'due process', although elements may be seen in their actions which are described in the following section. There was a systematic approach, but this was implicit rather than explicit in that the process appears to have been known mainly to those involved with standard setting rather than to all their constituents.

Consultative Accountability

It has become common for government to consult on both a formal and informal basis with interested parties and those likely to be affected by policies¹³. The publication in the UK of 'Green Papers', discussion papers and consultative documents frequently precede the decisions of government. Organised interests consider that they have the right to be consulted and the government has acknowledged a duty to consult. Such functional links may serve to legitimise both these interest groups and the final decisions made by government. Within non-government organisations, consultation may be enshrined in statute¹⁴ whereby advisory bodies, committees councils, boards or commissions are consulted as of right. In a governmental context, consultation may be seen as satisfying demands for open government and also for more participation in government decisions. Better decisions may flow from greater participation, and cases of conflict between governmental action and private rights may be mitigated by the introduction of formal mechanisms whereby private opinions could be expressed¹⁵. This situation is typified by the use of public enquiries as a forum for seeking the views of interested parties. These enquiries provide the opportunity for objections to be raised and proposals to be modified.

The implications of consultative accountability is that rule-making bodies may in fact be avoiding ex post accountability through involving a wider constituency in decision making. On occasions where the views of those affected figure predominantly in the subsequent regulation or judgement, then the rule making body rarely has to defend its' decision. The act of consultation may be interpreted as a form of consensus seeking. For assessing whether consultative accountability is present, it is necessary to look at the consultative procedures and attempt to assess whether these are attempts at collegiate decision making, information gathering exercises or merely window dressing. The development of the two standards

¹³ Smith (1981) describes this as almost a convention of the constitution.

¹⁴ The Electricity Act (1989) provided for the setting up 14 regional consumer committees and the Water Act (1989) , 10 regional customer service committees.

¹⁵ This also encompasses some of the rationales for use of agencies by government described in Chapter 3.

examined in the following Chapter demonstrate the effect of the consultation processes used by the ASC.

Consultative accountability examines whether decisions have been legitimised through wide participation. Where the development of accounting standards reflect consensus-seeking, then it would appear that the standard setting body is behaving in a responsible manner using the Birch (1964) interpretation of responsibility as incorporating responsiveness as well as accountability. Clearly, procedural arrangements for consultation to take place can be examined, but whether such consultation involves participation in decision-making, window-dressing or information gathering, requires a standard by standard analysis of the process. Previous chapters have already examined some of the interaction between accounting regulators and their constituents, through the informal meetings with interested parties and through the more formal mechanism of replies to Exposure Drafts¹⁶. Research carried out by Tonkin (1983) on comment letters, suggested that some groups of participants in the standard setting process tended to have more systematic success in having their views reflected in published standards than other groups. This research may not have addressed the issue of the members of the ASC (who would have made the final decision), coming from amongst those groups enjoying this success. Additionally, by its' nature, this research could not take account of those stakeholder groups who were not involved in the process. Generally, it has been recognised that certain interests (mainly those of users) are not well represented in the consultation process (Beresford, 1993).

Economic Accountability

The quest for efficiency within governmental departments and agencies has introduced the concept of economic efficiency. Because public funds are voted for a specific purpose, not only must there be a check that they have been properly spent, but also that waste has been eliminated. This has brought about more sophisticated forms of budgeting and financial

¹⁶ Discussion drafts are another way in which consultation is achieved and these usually suggest a range of possible solutions to an accounting problem, rather than proposing a single treatment.

control techniques within government, of which Value For Money (VFM) auditing is an example¹⁷. The creation of commercial type agencies provides a way in which managers are given 'clear-cut responsibilities and commensurate authority, and being held accountable for performance against budgets, standards of achievement and other tests' (Fulton Committee 1968 para 154). Economic accountability is already present in commercial organisations, whose annual accounts provide information not only on stewardship, but also on the efficient use of resources, using profits as a measure of economic efficiency. Within other organisations who are unable to report in terms of profits or losses, income and expenditure is subject to the traditional type of audit, although in addition to this, VFM auditing examines economy, efficiency and effectiveness within parts of the public sector. This encompasses what Robinson (1973) describes as programme accountability which is concerned with the achievement of goals, and although he recognises difficulties in the definition of goals, especially at central government level, he nevertheless argues that goal setting may be possible for subordinate parts of government.

A pre-requisite of economic efficiency is that organisational objectives must be clearly specified before any judgement can be made as to organisational success or failure. In the case of businesses operating within a capitalist economy, these objectives i.e. profit maximisation are inherent and involve efficiency considerations, but other organisations whose objectives are not so easily specified, introduce difficulties in measurement unless either subordinate goals can be laid down or performance measurement standards set.

Applied to accounting regulatory bodies, economic efficiency suffers from the initial difficulty of the specification of objectives. The ASC operated under a mandate with the general objective of setting accounting standards in the public interest. No form of performance measurement or evaluation in economic terms appears to have taken place. The ASC made

¹⁷ The Local Government Finance Act 1982, requires the Audit Commission to carry out such an exercise and the National Audit Act 1983 gives statutory power to the National Audit Office in respect of VFM audits.

an annual budget submission to the CCAB, although the funding came from the professional associations themselves, as described in Chapter 5. Presumably, if the accounting profession required non-governmental standard setting and flexible standards, they would be prepared to continue to support the ASC who could satisfy these objectives.

The objectives of the ASB are incorporated in their Memorandum and Articles of Association, but these once again provide a difficult standard against which to measure economic performance¹⁸. The Annual Review of the Financial Reporting Council includes a section on the work of the ASB, but this contains only a description of its' activities in the technical field.

Commercial Accountability

Commercial accountability applies only to those industries owned by the state and to certain special purpose agencies (usually set up on a commercial basis such as Her Majesty' Stationery Office¹⁹). There exists a very indefinite line of accountability here and a very unclear relationship between government and these bodies (described by Hanson and Walles, 1975 as a 'blurring of the dividing line between Ministerial responsibility and board autonomy p 181). Such industries are expected to operate commercially within a capitalist economy, although it is possible that there may be ideological as well as conceptual differences between governments and these agencies. In the case of state-owned industries it has consistently proved impossible to agree on a long term criteria for control and accountability purposes, although various techniques based on Return on Investment or Cost of Capital have been used to measure performance. The ambiguities of relationships between government and agencies may however be advantageous to Ministers who may wish to exert influence without becoming personally accountable for the undertaking. As accounting regulation cannot be considered a commercial

¹⁸ The Memorandum and Articles of Association gives as an objective 'to devise and promulgate accounting standards; to promote, maintain and codify best practice....to define concepts...to narrow differences....' 3 (iii).

¹⁹ Privatised in 1996.

activity, this type of accountability will not be examined further in this chapter.

Professional Accountability

Where professionals operate within the public or the private sector, there is an unsolved question as to whom they should be answerable. In the public sector, they may be responsible for the exercise of their skills and judgement to elected political leaders, to their fellow professionals or to both. Such a conflict of loyalties is examined by Klein (1974) in the context of the public health service. Rose (1985) quotes the example of medical malpractice being defined as failure to comply with medical standards rather than with bureaucratic procedures. Until recent changes in the public health service in the UK, 'the state had endorsed professional autonomy by handing judicial and other powers to a professional body without creating any method of checking the use of such power' (Smith 1981 p. 1171). Accountability only manifested itself at the highest level i.e. through parliamentary questions on matters of health policy. There has however been a long-term tendency towards a reduction in the independence of medical professionals recognised by Klein (1973) who describes medical duties as being defined by the terms of a contract rather than in the traditional form in terms of dedication. Later Perks (1993) describes managerialism curtailing professionals within organisations, although it has been recognised that limited technical knowledge (by managers) of the work of such experts can curb the effect of any constraints placed upon them (Wirt 1981)²⁰.

The implication of professional accountability is that although professionals, by virtue of those characteristics by which they are termed professionals²¹, are responsible to their professional associations, their positions within organisations also imply some level of responsibility, unless they are allowed to act in a totally autonomous manner within that organisation. Occasionally, both in the public and private sectors, this can lead to a conflict of duty.

²⁰ ie managers can be 'blinded by science'.

²¹ see Perks (1993) Chapter 1 for a discussion of professional characteristics.

Professional accountability is especially relevant to a body dominated by professionals and whose pronouncements apply in the first instance to fellow professionals. The question of whether professional regulatory body members are responsible to their professional associations at the expense of the regulatory body must be raised, unless both professionals and their regulators have objectives which are also shared with the rest of society. The studies quoted in Chapter 5 (Reagan, 1987) suggesting that professional norms contain value elements as well as technical abilities give an importance to both the professional and societal interpretations of public interest. When accounting standards were introduced in the UK in 1970, the regulatory body was a committee of the largest professional association (ICAEW); later it was formed from representatives of all professional accounting bodies, and it was not until 1982 that the first non-accountants were included. Thus for the first twelve years of operation, the ASC was the domain of accountants only, and even after the changes occurring in 1982, this situation hardly changed. Additionally, standards had to be approved by the CCAB which involved the consent of the main professional accounting bodies.

The ASB is now independent of the accounting profession, being set up as an incorporated company with arrangements as to the appointment of members contained within its Memorandum and Articles of Association. The fact that the Chairman and Technical Director are now full-time offices has tended to introduce even more independence. Other Board members however (unlike FASB members) are neither full-time or required to sever their links with industry or the profession. Accounting standard setting is still dominated on both sides of the Atlantic by qualified accountants and the inputs to the processes similarly tend to be dominated by preparers (who are accountants) rather than users (who often are not accountants). This has been noted by both Beresford (1993) in the US and Perks and Georgiou (1992) in the UK. Where professional accountability replaces conventional accountability in the area of accounting regulation, it is necessary for accountants and society in general to have shared values in order for public interest to be promoted and accountability to be present.

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Decentralised Accountability

Decentralised accountability involves the devolution of powers from central to regional and local governments, and the ensuing responsibilities arising from the granting and the exercise of such powers. As this concept is based on a geographical rather than functional or operational considerations, it will not be explored further in this paper.

THE ROLE OF ACCOUNTABILITY IN THE PRINCIPAL AGENT MODEL

Within the principal/agent model, the basic relationships consist of the granting of power and rewards by the principal to the agent, who then carries out actions on behalf of the principal. Such actions can only be monitored through the supply of information to the principals. The relationship is often referred to in accounting literature as agency theory, much of which is concerned with the provision of an incentive or reward system to ensure that the agent acts in accordance with the wishes of the principal²². But, the model does not have to be examined from this perspective and in fact describes many other environments. Agent and principal relationships exist throughout society wherever actions are undertaken by one or more actors on behalf of others. This may take place within either a formal or an informal setting and could incorporate explicit or implied responsibilities.

The principal/agent model may be found within a hierarchical structure as found in such examples as the military. It is present in theories of government (detailed later in this chapter), which describe the empowerment of one group by another²³. Within a corporate setting, the existence of the firm has been attributed to an agency relationship (Coase, 1937). Jensen and Meckling (1976) in describing the firm as 'a nexus of contracts', point to the existence of more agency relationships than the traditional director and shareholder relationship arising from the separation of corporate ownership and control. In whatever context the

²² see, for example Scapens (1991).

²³ Indeed the word responsible is often used in a political context to describe either action or inaction by governments (see Birch, 1964)

principal/agent relationship is found, accountability concerns the way in which the relationship is monitored and therefore is a vital ingredient.

The model of the relationship is illustrated as follows:

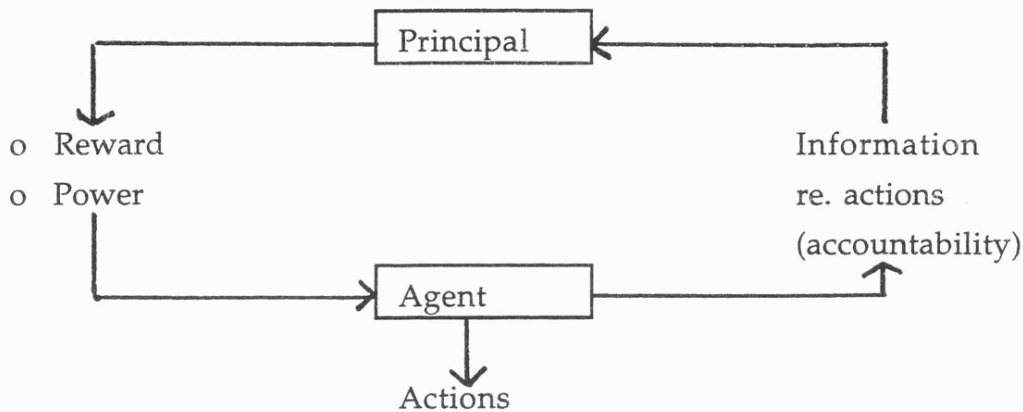


Figure 6.1 The principal-agent accountability contract (Adapted from Gray, Owen and Maunders (1987), p. 3)

In order to examine the nature of accountability, Rose (1985) asks four basic questions which address the relationships, functions and procedures shown in the preceeding diagram.

- * Who is accountable?
- * What are organisations accountable for?
- * To whom are organisations accountable?
- * How are organisations accountable?

In many ways, these questions are inter-related, but initially will be examined individually.

Who Is Accountable?

The identity of the agent depends upon the relationship being examined. Generally, the agent can be defined as the person or body carrying out actions on behalf of the principal. Within a market context, identification of the agent is usually clear, in that it is the principal who either formally appoints or more informally chooses to use the agent. Within a political setting, the same conditions do not always apply. Knowing who is accountable relies upon knowledge of functions and responsibilities. Hood

(1979) identified a lack of public knowledge about the division of responsibilities in areas of service provision²⁴. In the UK, the growth of the different types of agencies described in Chapter 1, has tended to exacerbate this situation. Holland and Fallons (1979) concern that 'The governed no longer know their governors', could demonstrate in some circumstances the problem of the identity of the agent. The indefinite nature of lines of responsibility in the case of agencies, is not a recent development (see Jennings 1930). This phenomena has also been recognised in the United States (Bernstein, 1955; Reagan, 1987), in Canada (Centre for Policy Studies 1982) and Australia (Parliament House 1989). Individuals may not be aware of the existence of the agency carrying out actions on their behalf, and indeed may not be aware of either the existence of or the implication of those actions. In a societal framework, one sector of society may appoint an agent on behalf of one other sector of society, or even society as a whole. Although the identity of the agent is clearly *stated*, it is not universally *known*.

Within the area of accounting regulation, the identity of the agent e.g. in the UK formerly the ASC, now the ASB and in the US the FASB, is clearly stated. However knowledge of the division of functional responsibilities may not be known. The UK system of accounting regulation relies on two sources in addition to accounting standards. Both company law and the London Stock Exchange regulations contain requirements relating to accounting. Many of their pronouncement are broadly similar to accounting standards (especially in the area of disclosure²⁵), however some disclosure is required by the Companies Act and the Stock Exchange only (e.g. analysis of loans), whereas deferred tax disclosure is covered by SSAP 15 and the Companies Act (1985). Moreover, there are areas where accounting standards clarify legal concepts such as the 'true and fair view'

²⁴ In this work, he challenged readers to match specific tasks against different government departments, government agencies and private sector organisations. The results illustrated that similiar tasks were carried out by different performers and that any one organisational type often carried out diverse functions. Overall, he demonstrated a complete lack of symmetry between the service and the provider.

²⁵ Segmental information is required by SSAP 25, the Stock Exchange and the Companies Act 1985.

as well as providing technical instructions which underpin other concepts contained in the law. The problem of identifying responsibility in service provision described by Hood (1979), is illustrated clearly by the presence of three 'agents' regulating accounting.

What Are Agents Accountable For?

Rose (1985) answers this question in terms of outputs, which in the case of private sector organisations are private goods supplied to the market at a price. There is implicit in such transactions a form of contract between the supplier and the consumer (usually backed up by a form of legal protection for the consumer). In the case of the supply of collective or public goods, the absence of price and market mechanisms means that although responsibility can be allocated for the supply of specific goods or services, accountability must take a different form. Public choice theory in policy matters means that different (consumer-based) mechanisms of accountability in service provision have replaced political accountability (Oliver, 1991). Consumers of some public services such as healthcare may now be able to choose their supplier of services in such a way that responsibility (achieved partly through the devolution of budgets) has shifted from central government to the individual supplier (Mayston, 1993). Because of the exercise of choice by the consumer, it is the supplier who is now accountable for the provision or non-provision rather than the government.

Where a contract exists, then the question of what an agent is accountable for will normally be contained within the terms of that contract, or where not explicit, general duties exist, such as the duty to perform the undertaking and the duty not to make a secret profit (Sealy and Hooley, 1994). In the case of government as an agent of the people, no contract exists directly, but this relationship is covered by theories of government based on the notion of a social contract. Such theories cover two types; firstly the Platonic version of a binding together of men for self interest, and secondly the idea of a contract with a ruler as described by Hobbes as the subjection of individuals to the Leviathan for the purpose of self-preservation. Locke subsequently described legislative and executive powers as 'nothing except the natural power of each man resigned into the hands of the community' (Sabine, 1937), the extreme version of which was

espoused by Rousseau in 'The Social Contract', in which he saw the relationship of people to the ruler not as one of contract, but where the government was the servant of the will of the people. Although such contract theories have been criticised as being merely descriptive of the origins of society, nevertheless these ideas are embedded in traditional democratic theory in which 'power emanates from the people and is to be exercised in trust for the people' (Smith & Hague, 1973, p. 26). Summarising (and perhaps oversimplifying) the historical perspective of government, its role would appear to consist of protecting the individual and acting in the public interest, and although these objectives are difficult to quantify, they would appear to be sufficiently robust to apply to modern democratic states.

Within a corporate setting, the traditional purpose of accountability was for stewardship purposes, whereby resources entrusted to an agent had to be accounted for on a periodic basis (Chatfield, 1977; Oschinsky, 1978; Beaver, 1981). From this, developed the audit as a check on the accuracy of information and hence on the honesty of the steward. Over time, the notion of stewardship and therefore accountability came to be re-defined to reflect the more pro-active role of the agent. Porter (1989) uses the approximate time period of 1930-1960 to describe the extension of corporate accountability to the areas of the efficient and effective use of resources, although it is difficult to imagine that shareholders prior to 1930, were not concerned with profit-maximisation²⁶. The Porter time period model of accountability²⁷ adds socially responsible behaviour to the post 1960 period. This extension is partly as a result of the growing interest in environmental issues and green accounting (see Gray et al, 1987; Owen, 1992; Perks, 1993).

In both the corporate and the political contexts, the agent is expected to act in the public interest because actions taken will impact upon society as a whole. If accounting regulation (and subsequent enforcement of those

²⁶ Even though, it was not until the 1929 Companies Act that there was a requirement to publish a profit and loss account, indicating an increased demand for this information.

²⁷ Porter divides into three time periods, stakeholder groups to whom company managers are accountable, and also what such managers are responsible for.

regulations) is important to society, then the regulators should be working in the public interest, a characteristic which contributes to the rationale for their existence (Lemak, 1985; Stigler, 1971; Noll, 1971). This aligns the responsibility of the regulators with the type of responsibilities which might be found under a social contract. The basis for accounting regulations should therefore be not only explicit, but also generally acceptable. Conceptual framework projects are one way in which a social consensus may be identified, and this perhaps is the rationale for the resources which have been expended both in the US and the UK on such projects. Whether the results of such framework projects are acceptable must depend upon whether they succeed in reflecting the views of society. Conflicting demands by users may cause problems both to a framework as well as to individual pronouncements. The resolution of such conflicts are within the realm of politics, with Carsberg (1977), suggesting that an interpersonal comparison of utilities of user groups of accounting information needs to be made, with the final responsibility for choice resting on Parliament or the professional accounting bodies subject to the control of Parliament.

To Whom Are Agents Accountable?

It would be too simplistic to attempt to answer this question in terms of the principal, without stating the criteria necessary for the identification of the principal. Within a liberal democratic setting, the governors are accountable to the governed. This is achieved through a system of responsibilities in the UK; local governments to central government, civil servants to ministers, ministers to the assembly and the entire government as represented by the cabinet to the electorate. Ultimately, therefore, the principals are citizens who are able both to legitimise the power given to governments as well as to reward and punish (through either re-election or voting out). A problem arises under social choice theory in that there may not exist a well-defined set of social preferences which can represent the views of the electorate as a whole. Thus the electorate cannot be classed as a single, well-defined principal (Mayston, 1993), but would appear to be a range of individuals each with different values and aspirations who nevertheless become the principal of the government of the day.

In the case of business organisations, the traditional view was that the directors were accountable only to shareholders and this was effected mainly through the issue of annual accounts²⁸. This view was effectively contained in law, and the latitude given in early UK Companies Acts, confirmed the belief that accounting was a matter of negotiation between shareholders and directors (Edey and Panitpakdi, 1956). The accounting professions' perspective until 1974, when accounting Recommendation N15 from the Institute of Chartered Accountants in England and Wales (ICAEW) was withdrawn, stated clearly that the primary purpose of annual accounts was that of presenting information to the proprietors. The 1960's and 1970's saw the growth of the stakeholder view of the firm²⁹, whereby it was accepted that groups other than shareholders were affected by the actions of firms and therefore these firms were expected to be accountable to a wider range of groups (see Perks, 1993; Tower, 1993; ASSC, 1975). Conceptual framework projects since the 1970's (ASB in the UK and FASB in the US for example), have all tended to recognise a similar range of user groups. The role of the law within this relationship has been described as providing the 'rules of the game in which the organisation chooses to play, (and) becomes the terms of the social contract between society and the organisation' (Gray et al 1988 p 13, brackets added). This view has been criticised on the grounds that the law reflects the role of the state and the distribution of power in society rather than the view of the stakeholders. However, these stakeholders, possibly not sharing a set of similar preferences, are unlikely to present a single demand for accountability and multiple demands confuse rather than increase the accountability of organisations (Stewart 1984)³⁰.

Auditing provides an example of the sometimes hidden relationship between agent and principal. The appointment of auditors is confirmed by

²⁸ Although certain voting rights and the ability to attend the Annual General Meeting were also traditional accountability mechanisms (and perhaps still are).

²⁹ Expressed in an extreme form by Dahl (1972) in that '...every large corporation should be thought of as a *social enterprise*; that is an entity whose existence and decisions can be justified insofar as they serve public or social purposes' (p. 17).

³⁰ In an accounting context for example, demands for environmental information may be required by some groups, whereas certain investors may not want this disclosed.

shareholders at a statutory annual meeting. Furthermore, the report of the auditors is addressed to the members (shareholders) of the company. Yet despite this, the directors are able to act almost as principals in the shareholder/auditor relationship, in that they have a decisive influence on the appointment of the auditors and there is also a perception of the directors as being the client of the auditors (Whittington, 1993)³¹.

If accounting regulators are the agents, then the users of financial statements are the principals. As described earlier in this chapter, company law in the UK originally considered only investors and creditors worthy of protection and therefore regulated accounting with these two groups in mind. The stakeholder view of the firm has recognised a number of user groups and therefore the number of principals on whose behalf regulation is carried out. Different utilities and value systems of user groups weaken accountability which is maximised when there is one clearly defined agent and one homogeneous group of principals. The stakeholders moreover, tend not to act as principals in that in general they do not all articulate their demands to their agents. Neither are they a party to any process of accountability if they are not aware that actions are being performed in their name. The lack of involvement of groups other than professional accountants is a recurrent theme. The regulators and those providing the inputs to the process appear not to be representative of society as a whole.

How Are Agents Accountable?

Within a political arena, the principal is held accountable through elections, although checks and balances introduce intermediate forms of accountability in the administrative machinery. Smith & Hague (1973), describe the devices whereby a democratic government may be held to account as 'External and internal audit, scrutiny by mass media, legislative oversight, party responsibility, the electoral process..' (p. 26). The UK system of government enables ministerial accountability to take place on a continual as well as periodic basis. The level of scrutiny of government would appear to have increased through the introduction of audit techniques which examine qualitative as well as quantitative

³¹ The US model of auditing embraces this situation by the addressing of audit reports to both directors and shareholders.

matters, and also through the increase in investigative media journalism. Within the framework of accountability, Stewart (1984) describes a spectrum ranging from accountability by standards to accountability by judgement³². Audit techniques could refer to standards in that performance measurement may be compared to prescribed standards and mass media and party responsibility could refer to matters of judgement. Whereas 'the currency of accountability is information' (Parliament House, 1989, p. 8)³³, the effectiveness of accountability systems rely upon freedom of information (Oliver, 1991). Although the presence of an audit is a means of increasing accountability by verifying the reliability of information, this is dependent to a degree on subjective judgement where the verification of physical phenomena does not take place. In addition to being reliable, information must also be understandable to the principal. Where the task of the agent involves complex or technical areas, the mere reporting of actions taken will not necessarily allow the principal to judge whether the agent has acted properly. Perks (1993) recognises the necessity of matching information with needs;

'If accountability is going to be an emancipating concept that helps liberate those in society who are less powerful, it is important that information is made available in accordance with their needs without being biased by intermediaries'

(p. 41)

An additional problem arising from accountability in the principal agent model is that unless the principal has power over the agent, accountability loses its basis of validity. A system of holding to account is a necessary condition (Stewart et al, 1992), but not a sufficient condition according to Jones (1977);

'Accountability cannot be discharged simply by an explanation and publication of actions - for accountability to

³² Accountability by standards requires comparison with something definite eg is it legal? whereas judgement requires a more qualitative approach such as asking if a certain policy is correct.

³³ This was recognised in the 19th century by Bentham; 'Central to Bentham's understanding of the accountability process was the principle of publicity. This implied the rendering of an account to a public realm was integral to the process whereby accountability was discharged'. (Gallhofer and Haslam, 1993, p. 321)

exist there must be the facility to evaluate actions and then apportion praise or blame, the extreme version of which would be the ending of the principal agent form with its existing actors' (p. 14)

The principal therefore must have the ability to replace or at least impose some sanction over the agent. From this arises a potential struggle (Perks 1993), whereby both agents and principals try to control the accountability process, thereby increasing or decreasing their relative power.

Within firms, the traditional method of accountability has been contained within company law. The availability of information is essential to the monitoring process which must take place within the agent principal relationship.

'In general, the principal requires that the agent act towards a particular end and that these actions are rendered visible by some form of account(ing)' (Power, 1991 p. 32).

Watts and Zimmerman (1986), give examples (p 196) of types of contracts using accounting numbers and note that actions are often restricted by reference to these numbers. Ormrod and Cleaver (1993) relate the information content of company annual reports to certain types of contracts within the firm, quoting articles of association, loan contracts, listing requirements and director's remuneration contracts as examples.

Keasey & Wright (1993) in the context of the debate on corporate governance state;

'Accountability, which is a sub-set of governance, involves the monitoring, evaluation and control of organisational agents to ensure they behave in the interests of shareholders and other stakeholders.' (p. 291)

At the heart of this process is accounting, described by Roberts and Scapens (1985) as institutionalising 'the right of some people to hold others to account for their actions' (p. 445). The production of financial information is a key element in the success of an effective corporate governance system (Whittington, 1993). There is however in this connection the problem of information asymmetry discussed by Mayston (1993) who considers that imperfect information could impinge upon

accountability, because those with more information may have an incentive to use this resource to shift risk to less informed participants³⁴. Certain of the concerns in the debate on corporate governance relate to creative accounting and business failure. The role of the auditor is clearly related closely to these areas³⁵.

Information would appear to be the way in which accountability is enacted and verified. Information however may have a number of different dimensions. Stewart (1984) considers that each type of accountability has a different information requirement. The Cadbury report on corporate governance appeared to recognise this in its recommendations that strengthening accounting and audit procedures alone, would not solve current problems relating to the management of company.

Insofar as accounting regulation, is concerned, the two key principles of accountability described by Rose (1976) as elections and markets do not exist. Within the setting of a democratic government, accountability exists in this form, whereby governments have to present themselves periodically to their principals for re-election. Similarly in the UK, directors of companies have to be re-elected periodically at Annual

³⁴ See also Bromwich,1992 and Brealey & Myers,1988.

³⁵ The auditor's role in verifying data may not be independent because of possible influences on impartiality (Perks, 1993; Whittington, 1993; Sikka et al, 1992). Not only may the auditor be biased, but may also be partly responsible for limiting accountability because the UK auditors' role is legally rather than economically defined (O'Sullivan 1993). This is evidenced by various legal judgements eg Chandler v Crane Christmas (1951) in which the Court of Appeal decided that there could be no liability in the absence of a contractual relationship. Although this was reversed by subsequent legal judgements, nevertheless, the opinion that accounts are prepared for stewardship purposes rather than investment purposes (Caparo Judgement 1990), effectively defined the identity of the principal, limiting any liability by the auditor to existing shareholders. Concerns about the 'expectations gap', originally investigated by the Cohen Commission in the US in 1974, still exist and serve to undermine belief in an extremely important element of accountability.

General Meetings which all shareholders have the right to attend. The fact that directors are rarely removed from office is probably more a function of shareholder ignorance arising from information asymmetries or shareholder inertia rather than a favourable comment on the actions of all directors. Accounting regulators have in the past been appointed (in the case of the ASC, ASB and FASB) for a fixed period of time. It is not the standard setting body which has to present itself generally for re-election, but the individual members who seek re-appointment. In theory, the CCAB could have disbanded the ASC and there exist powers for the government to remove from office any directors of the FRC³⁶ and appoint others, thus replacing the entire ASB. This rather extreme action displays few of the characteristics of elections³⁷, and would suggest somewhat overt political interference. There exists no market for accounting regulation and therefore market forms of accountability are not applicable.

The question must arise of whether there exists information which would enable any sanctions to be taken against the regulators. Information does exist regarding the actions of regulators. Firstly their pronouncements, together with articles in the press and professional journals describe their actions. In addition, it has become common for regulatory bodies in general to produce an Annual Review or Report, which summarises their activities over the course of a year. There would appear to have been little in the way of a regular or formal independent evaluation of the work of accounting standard setters. The only example found by the writer is a comprehensive study of FASB (Louis Harris, 1985), based on questionnaires to user groups, but this was carried out in 1985, and no similar exercise has been carried out since.

³⁶ The power is held jointly by the Secretary of State for Trade and Industry and the Governor of the Bank of England in S 23(b)(ii) of the Memorandum and Articles of Association. The Appointments Committee of the ASB consists of the directors of the FRC plus three other members (who they appoint).

³⁷ The question of who forms the electorate is crucial to this issue. Normally, those who are entitled to vote are those affected by the decisions of those for whom they vote.

SUMMARY

It would appear that UK private sector accounting regulation appears to escape the degree of accountability that would be forthcoming if the activity were carried out by government. This is not a criticism aimed only at accounting regulators as they are but one example of power exercised outside of government. Avoidance of the traditional constitutional form of accountability has led to the new forms described in this Chapter. Although judicial accountability is always present, the law in the UK has effectively delegated powers to regulators, allowing the 'true and fair override' to reconcile some differences whilst enabling detailed practices to be specified within a general legal framework. The interview with Watts (1978) quoted in Chapter 1 demonstrated that the ASC considered themselves as making a kind of law. Quasi-judicial accountability can only occur where regulators are working under a form of delegated authority arising under legal guidelines. Procedural accountability requires some form of explicit system of internal organisation and processes, and in the absence of these it is difficult to see how this could take place. Consultative accountability again looks at processes, but lack of participation by some stakeholder groups may lead the consultation process to be little more than either a window-dressing exercise or the imposition of the view of a powerful interest group. Economic accountability requires either a corporate body whose objectives can be measured in terms of profit-maximisation or another body with clear objectives who are subject to a more qualitative VFM type of audit. The ASC as an unincorporated committee escaped any form of audit, whereas the ASB as a registered company has a commercial type of audit, more suitable to an organisation operating under commercial (profit-maximising) objectives. Insofar as professional accountability is concerned, this may perhaps be termed a 'conflicting concept', in that the process of accounting regulation is dominated by members of a single profession. Only if the members of the accounting profession share the same norms and values as the rest of society, will professional accountability bring about social accountability.

Using a principal agent perspective, identification of both the agent and the principal would seem straightforward, however mutual recognition may not exist. There may well be a lack of knowledge of the existence and the functions of the agent by certain of those stakeholder groups comprising the principal. Awareness of the needs of the principal even if

acknowledged in regulatory pronouncements by the agents, may have been assumed rather than received by way of instruction. The type of mandate given to other regulators especially in example of the utilities, specifically talk of the interest and protection of consumers. This could be reconciled with the original mention of 'public interest' in the ASC constitution; however this term has now been replaced by the term 'best practice'. Traditionally in the UK prior to the quasi-legal backing to standards, little power appears to have been exercised over the agent except that the regulators had to practice a high degree of consensus-seeking³⁸ in order to secure acceptance of standards. This consensus was partial, in that it was achieved among preparers rather than users. Additionally, there would appear to be no systematic way in which information for accountability purposes is passed to the principals where these are defined as stakeholders. Routine reports of the activities of the regulators are published by both ASB and FASB, although there would not appear to be (in the UK at least), any formal methods of evaluating this information and acting upon it.

Although both political and corporate organisations have appropriate channels for the communication of information to stakeholders, many agencies do not supply useful information for the purpose of performance analysis. Additionally, the use of an unsuitable form of audit as described earlier in this Chapter does little to overcome this deficiency. Such information as is produced may be difficult to understand, thus breaching another necessary condition for accountability to exist.

³⁸ Detailed in the following Chapter

CHAPTER 7

AGENCY OPERATIONS

INTRODUCTION

An examination of the operations of an agency should include both the internal method of reaching decisions and the external influences on the process (although these two areas may be interconnected). In the case of accounting regulation, the external influences arise mainly from the producers and users of accounting information. The approach taken in this chapter is to enlarge upon the development of the two standards analysed in earlier chapters by studying the changes that occurred between the issue of ED 27 and SSAP 20 (Foreign Currency Translation) and between ED 30 and SSAP 22 (Accounting for Goodwill).

The analysis of ED 27 concentrates on the following four areas of the draft:

- o Whether temporal or closing rate should be the translation method used.
- o Whether the profits of subsidiaries should be translated using the closing or an average rate.
- o Whether the offset of borrowings against the net investment should be restricted to those borrowings denominated in the same currency as the foreign equity investment.
- o Whether long-term loans and inter-company balances between a holding company and its subsidiary could be treated as an equity investment by the holding company.

The analysis of ED 30 concentrates on the following areas:

- o Whether purchased goodwill should be written-off immediately or capitalised with subsequent amortisation.
- o The period over which capitalised goodwill could be amortised.
- o Whether non-purchased goodwill could be included in the accounts.

In both of these Exposure Drafts and Standards, only the areas applicable to consolidated financial statements will be examined rather than those relating to the individual company treatment. The majority of respondents to both Exposure Drafts by way of comment letters tended to be large companies or those firms of accountants involved with large companies, who generally operated through a group structure. Under s 230 of the Companies Act (1985), there exists an exemption available from the publication of the holding company profit and loss account and this exemption was generally utilised by companies at that time, which meant that the individual company treatment tended not to be relevant to them¹. The analysis of profit and loss accounts and balance sheets are normally focused on the group rather than the holding company, and therefore it would appear that the consolidation treatment of both foreign exchange and goodwill is more important than the individual (holding company) treatment.

A further reason for limiting the areas of the analysis is that an examination of the effects of external pressures, as demonstrated by the comment letters may be more reliable by eliminating both ambiguities and subjective interpretations that may be present where more complex or inter-related issues are analysed. Beaver (1981) talks of the practical problem of the determination of preferences. For example, a classification or categorisation of comments relating to disclosure must by its nature often contain these inherent flaws. Analysis of Exposure Drafts or Standards through a physical count of the number of times a word appears (Hudack & McAllister, 1994), or the multi-faceted type of analysis carried out by Tomkins (1983), would appear to be susceptible to subjective interpretation and may ignore a situation where a respondent is attempting to trade-off one aspect of a proposal against another². Indeed, Watts & Zimmerman (1979) consider that the reasons for supporting or opposing a particular regulation may not reveal the honest motive of the individual.

¹ In the case of the goodwill standard, it was goodwill on consolidation which was referred to in most reply letters, as few large companies tend to take over unincorporated enterprises.

² Holthausen and Leftwich (1983) consider that lobbying preferences are not unambiguously revealed, in that lobbyists may support parts of a proposal and oppose other parts.

The areas selected for analysis in this chapter represent separate and identifiable accounting policy choices. For example, the preferred choice of method of translation of foreign currency was clearly expressed in comment letters and could therefore be compared with both the Exposure Draft and the Standard. By concentrating on fundamental issues, the 'honest motives' are revealed as, for example it would be unlikely that a company who wished to write-off goodwill immediately would advocate the opposite treatment (capitalisation) as a trade-off against another proposal in the Exposure Draft.

THE REGULATORY PROCESS

In 1982, the ASC produced a paper entitled The Standard Setting Process (ASC 9/50), breaking down the stages in the development of an accounting standard. The first of these was the initial research³ followed by a drafting sub-committee with three or more members nominated by the ASC⁴. The initial draft was then reviewed by the ASC and sent to the Technical Committees of the CCAB members, following which, the draft could be amended. Consultations were then held with interested parties i.e. financial directors and senior officials of companies whose financial statements would be affected significantly by the proposals. Additionally consultations were held with the Companies Division of the Department of Trade. Although the document does not mention any further amendments before the publication for general comments, it might be reasonable to assume that these would be incorporated. It is claimed that more than 100,000 copies of exposure drafts were published for comment, but this appears to contradict the figures quoted in Chapter 3. Each member of the ASC received a copy of all comment letters and 'the working party responsible for the particular subject will review in detail these comments' (letter dated 14.11.81 from K O Robinson, secretary of ASC {ASC 2/35/1}). The secretariat of the ASC prepared a summary of the comments received for the use of Committee and sub-committee

³ In the case of goodwill, there were studies from Arthur Andersen, Touche Ross and B A Rutherford of University of Kent.

⁴ It is interesting to note that the words 'working party' were not used in this document, even though it must be their activities which are being described.

members only. Finally, following any further amendments, the proposed standard was sent to the CCAB member bodies whose Councils if in agreement approved the standard for issue to its own members.⁵

There appears to be little evidence of the way in which the ASC dealt with the comment letters other than by the process outlined above. In a letter to a firm of accountants, K O Robinson, ASC secretary, states that;

'We have no system of weighting comments, nor do I think we should have one as (a) it would be extremely controversial and (b) it would perhaps cause us to overlook some good points raised by small groups or individuals.' (letter to Donald Heady & Co dated 20.1.1983, ASC 2/49/2)

In the same letter, Robinson also admits that it seems 'anomalous that a small group gets, on the face of it, the same rating as, say the whole of the TAC.' (Technical Advisory Committee). An interpretation of these comments could be that the ASC assigned the same weighting to all comment letters and therefore used some simple tally of preferences or objections.

STUDY 1 - SSAP 20

Introduction

SSAP 20, Foreign Currency Translation was issued in April 1983. This followed the production of three Exposure Drafts by the ASC. The first of these in September 1975 was ED 16 'Supplement to Extraordinary Items and Prior Year Adjustments', which covered realisations and revaluations of fixed assets as well as foreign currency translations. This section of the draft was brief, dealing only with simple translation and conversion matters in some three paragraphs, and not differentiating between individual companies and groups. During the exposure period, many of those respondents addressing this part of the draft, pointed out that the subject was so important that it warranted its own standard.

⁵ It was usual for each council to approve a standard subject to it being approved by the other five Councils

The perceived importance of a separate standard and the fact that little guidance had been given in respect of foreign exchange⁶, led the ASC to issue ED 21 (Accounting for Foreign Currency Transactions) which was published in September 1977. Although this limited the options available to the use of either the closing rate or temporal method, it gave no indication as to when either method could be used⁷. Apart from this open choice, one of the main criticisms of the standard was that there was 'a lack of clarity in the distinction between the treatment of exchange differences in individual companies, and those arising on consolidation' (Davies et al, 1994 p395). This deficiency was remedied by the next exposure draft on the subject (ED 27, October 1980), which clearly sectionalised both the individual company stage and the consolidated financial statement stage. This distinction was carried through to the final standard SSAP 20 (Foreign Currency Translation), issued in April 1983.

The Draft And Standard Compared

Although changes did occur between the first two exposure drafts, these have not been included in the study as ED 16 had little substance relating to foreign exchange, and the lack of distinction between individual companies and groups in ED 21, does not constitute a sound basis for an analysis of the changes brought about following the exposure period and the possible role of the comment letters in this process.

The treatment of the four areas examined in this chapter in both the Exposure Draft and the Standard were as follows:

⁶ The Economist had already described exchange fluctuations as being the most important distorting influence in company accounts and had criticised the accounting profession for failing to provide a solution some five years after the decision to float sterling (reported in Accountancy, Nov 1977).

⁷ Additionally, it allowed profit to be translated at either the average or closing rate, and permitted the offset of deficits in foreign currency net borrowing in the reserves against movements on fixed assets.

Table 7.1 Comparison of ED 27 and SSAP 20.

AREA	ED 27	SSAP 20
<u>Method of Translation</u>	Closing rate should normally be used (s 51), unless trade of subsidiary is a direct extension then temporal method should be used (s 54).	Closing rate should normally be used (s 52). In circumstances where the trade is more dependent on the economic environment of the investing company's currency than that of its own reporting currency, the temporal method should be used (s 55)
<u>Translation of Profits</u>	The profit and loss account of a foreign subsidiary should be translated at an average rate for the period (s 53)	The profit and loss account of a foreign enterprise accounted for under the closing rate/net investment method should be translated at the closing rate or at an average rate for the period (s 54)
<u>Offset of Borrowings</u>	Where the proceeds of foreign loans raised by a holding company have been used to finance equity investments... differences may be offset.... provided that foreign equity investments (are) in the same currency. (s 57) brackets added.	Where foreign currency borrowings have been used to finance, or provide a hedge against group equity investment in foreign enterprises, exchange gains or losses on the borrowingsmay be offset as reserve movements against exchange differences arising

on retranslation of net
investment...(s 57)

<u>Long Term</u>	Long term loans and	Where financing...is
<u>Loans</u>	other inter-company	intended to be.... as
	balances between a holding	permanent as equity,
	company and a subsidiary	such loans and inter-
which are in substance	company balances
	equity investments should	should be treated as
	be treated by the holding	part of the investing
	company as equity invest-	company's net
	ments.....(s 58)	investment... (s 20)

Comment Letters

There were a total of 107 comment letters received by the ASC and these have been analysed according to the categories used by the CCAB bodies at that time.

Table 7.2 **Categorisation of comment letters received on ED 27.**

Companies	46
Professional Accounting Firms	20
Representative Bodies of Accountants	12
Other representative Bodies	13
Others	16

The representative bodies of accountants include one submission from the Technical Advisory Committee (TAC) of the ICAEW which had received 21 submissions from District TAC's. The individual district submissions were not available. 'Others' consisted of fifteen individuals and one firm of consultants. Many of the respondents only commented on part of the draft, giving a low response rate to each of the four sections. The

preferences expressed by respondents in each of the four areas examined was as follows:

Table 7.3 Translation method preferences expressed in comment letters.

<u>Respondent</u> <u>Group</u>	<u>Closing</u> <u>Rate</u>	<u>Closing Rate</u> <u>Only</u>	<u>Closing Rate with</u> <u>Limited Temporal</u>	<u>Choice of</u> <u>Method</u>
Companies	10	5	6	3
Accountants	5	3	5	1
Rep Bodies	0	1	4	0
Other Rep	2	0	0	0
Others	3	0	0	0
Total	20	9	15	4

Column 1 represents the number of replies which stated that they considered the closing rate to be the most suitable method of translation, whereas column 2 represents the views of those who considered that only the closing rate should be used on consolidation. The method outlined in column three is that proposed by the Exposure Draft.

Table 7.4 Profit translation method preferences expressed in comment letters.

<u>Respondent</u> <u>Group</u>	<u>Closing Rate</u>	<u>Average Rate</u>	<u>Either</u>
Companies	20	10	10
Accountants	1	7	2
Rep Bodies	1	2	6
Other Rep	1	1	4
Others	2	3	0
Total	25	23	22

Table 7.5 Offset preferences expressed in comment letters.

Respondent

<u>Group</u>	<u>Offset in any currency</u>	<u>Limited Offset</u>
Companies	23	4
Accountants	4	4
Rep Bodies	5	0
Other Rep	6	0
Others	1	0
Total	39	8

Limited offset includes those who felt that the limitation should apply to closely related currencies and not simply the same currency.

Table 7.6 Preferences for treatment of inter-company loans expressed in comment letters.

Respondent

<u>Group</u>	<u>Treat as Equity</u>	<u>Do not Treat as Equity</u>
Companies	4	0
Accountants	5	0
Rep Bodies	1	0
Other Rep	1	0
Others	1	0
Total	12	0

Analysis of Results

There were broadly no changes between the draft and the standard in respect of the method to be used. The standard contained a little more detail of when the temporal method could be used. This was in line with certain comment letters e.g. Rank Organisation (20.2.81) who requested additional guidance and Touche Ross (2.3.81) who felt that the guidance given was not sufficiently specific and suggested alternatives. Those advocates of the exclusive use of the closing rate consisted of five companies, three firms of accountants and one representative body. There

were no supporters of the exclusive use of the temporal method. If it is assumed that companies adopt a producer rather than a user orientation towards their view of best practice and that firms of accountants are not keen to have unpopular standards imposed upon their clients, then the preferences of these groups could have been satisfied by the pronouncement of the final standard. Those respondents expressing a preference for the closing rate could be satisfied by the standard as would those advocates of closing rate with limited use of temporal. Those who supported the exclusive use of the closing rate would also be satisfied by the outcome, as they could always use that method. The use of the temporal method for any subsidiaries was a matter of subjective opinion as to the relationship between the holding company and its subsidiaries and therefore either method would probably have been available to them on this basis. Insofar as those companies who wanted either were concerned, they, (Beecham, Coats Patons and Esso) all used the closing rate and so their needs were already met.

The treatment of the translation of the profit and loss account changed between the Draft and the Standard, from the use of the average rate only to a choice between the average and the closing rate. The analysis of the three possible options show that the respondents were almost equally divided between the three choices. Among companies, the majority stated a preference for the closing rate, and this indicated that this was general practice⁸. Again taking a producer view of the policy choices, the final standard satisfied all preferences through allowing either treatment. Those respondents favouring the average method were concerned that either a simple average should not be used (Allied Breweries for example suggesting a 4 weekly average) or that the standard should provide guidance on the method of calculation (Peat Marwick, Deloitte Haskins and Sells). Once again, the Standard steered a course between these preferences by stating 'The average rate should be calculated by the method considered most appropriate for the circumstances of the foreign enterprise.' (s 54) Surprisingly however, there was no mention in the Standard of the disclosure of the averaging method used.

⁸ Beecham in their comment letter of 26.2.81, quoted the fact that 27 out of the top 30 companies used this method.

The offset of borrowings was another area in which the draft changed significantly, but still managed to satisfy preferences. Under the standard, the offset was no longer limited to foreign loans raised in the same currency as the foreign investment. This was the preference of some 39 respondents; the remaining looking for some form of limitation to the set off but not necessarily the same rigours of the procedures outlined in the draft. The only supporters of this limitation were companies and firms of accountants. From a producer viewpoint even those in the minority could achieve their preferences as the set off was voluntary (s 57). Thus they could limit the offset of loans to the restricted situations where loans were in the same currency as the investments and therefore continue using their chosen policies.

The proposed treatment of long term loans and other inter-company balances as equity, was only commented on by twelve respondents. Of these, all felt that such items should be treated as equity reflecting perhaps the doctrine of substance over form which would allow such treatment of long term items in this way.

Contemporary Practice

Contemporary practice would appear to concur with the replies to the exposure draft. Surveys of published accounts during the 1970's tended to reflect only the then current issues in foreign exchange translation and therefore only data relating to the method of translation is available.

Table 7.7 Methods of translation used 1970/71 and 1978/79.

	<u>1978/79</u>		<u>1970/71</u>	
	Nos	%	Nos	%
Closing Rates	245	95	205	90
Temporal	<u>14</u>	<u>5</u>	<u>24</u>	<u>10</u>
	<u>259</u>	<u>100</u>	<u>229</u>	<u>100</u>

Source - Survey of Published Accounts 1980, ICAEW.

Although the second method is classified as temporal, it covered the method known as current/non-current, which has similar features to temporal. Over the period of the survey, there appears to have been a movement towards the use of closing rates by companies, which is reflected in the expressed preferences.

International Practice

The International Accounting Standards Committee had produced a statement E 11 in 1977 which allowed the use of either the temporal or the closing rate method, this element of choice being a feature of many early international standards. In the US, the original authoritative pronouncement by the AICPA had advocated the use of the temporal method, which was endorsed by SFAS 8 (Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements) in 1975. Criticisms of the effects of this standard (see Chapter 1) led to its replacement in 1981 by SFAS 52 (Foreign Currency Translation) which advocated the use of the closing rate for the balance sheet and the average rate for the profit and loss account.

Contemporary Opinions

The technical press tended to be critical of the fact that a choice of methods had been allowed by the previous Draft (ED21), and did not appear to be over-concerned with the questions of the translation of the profit and loss account, the offset of borrowings or the treatment of loans as equity investments. The Economist had originally been particularly critical about the lack of a single solution⁹, but the majority of other commentators were concerned that the solution should be harmonised with the US standard FAS 52 which permitted only the closing rate.

⁹ The title used in the Economist article of 1st October 1977 was 'Rudderless in a floating world'.

STUDY 2 - SSAP 22

Introduction

In October 1982, the Accounting Standards Committee produced Exposure Draft 30 'Accounting for Goodwill'. Following the period allowed for comments to be made up to the 31st March 1983, the subsequent Standard (Statement of Standard Accounting Practice 22, Accounting for Goodwill), was issued in December 1984 as the first UK accounting standard on goodwill.

Table 7.8 Comparison of ED 20 and SSAP 22.

AREA	ED 30	SSAP 22
<u>Consistency</u>	'Purchased goodwill should be eliminated from the accounts by selecting one of the two following policies and following the selected policy for the goodwill arising on all acquisitions (para 56).	'Nothing in this standard precludes a company from using both the immediate write-off treatment and the amortisation treatment in respect of goodwill which relates to different acquisitions' (para 35).
<u>Treatment</u>	(a) 'amortising through the profit and loss account in arriving at profit or loss on ordinary activities on a systematic basis over its estimated useful economic life	'Purchased goodwill (other than negative goodwill) <i>should normally</i> be eliminated from the accounts immediately on acquisition against reserves' (para 32).
	or	

	(b) writing off immediately on acquisition directly against reserves representing realised profits' (para 56).	Purchased goodwill (other than negative goodwill) <i>may</i> be eliminated from the accounts by amortisation through the profit and loss account' (para 34). (Italics added)
<u>Period of Amortisation</u>	'The estimated useful economic life should not exceed 20 years' (para 57(f)).	No upper limit specified.
<u>Non-Purchased Goodwill</u>	'No amount shall be attributed to non-purchased goodwill in the balance sheets of companies or groups'. (para 53)	 (para 35)

Comment Letters

There were a total of 96 comment letters received by the ASC in reply to ED 30. This represents a lower level of response than that of ED 27, despite the fact that in this total the District Societies were counted individually, whereas in ED 27 they were included as a single reply. These have been analysed again according to the classifications used by CCAB members (which varies slightly from that used for ED 27) as follows:

Table 7.9 Categorisation of comment letters received on ED 30.

Companies	25
Professional Accounting Firms	24
Representative Bodies of Accountants	28
Other Representative Bodies	9
Individuals	7
Miscellaneous	3

This final category included letters from the Department of Trade and Industry, the London Stock Exchange and the Greater London Council.

The following tables of replies show the expressed preferences in respect of the three areas under consideration. The number of respondents does not equal the totals under each of the three categories as some respondents did not comment on all items, with some commenting only on an aspect of the draft e.g. disclosure, not covered by this study.

Table 7.10 Preferences expressed in comment letters for accounting treatment of goodwill.

<u>Respondent</u>	<u>Immediate</u>	<u>Amortise</u>	<u>Either</u>	<u>Retain</u>
<u>Group</u>	<u>write-off</u>			
Companies	7	4	7	4
Accountants	4	6	8	2
Rep Bodies	6	2	14	0
Other Rep Bodies	1	0	4	0
Individuals	4	1	1	0
Miscellaneous	0	0	1	0
Total	22	13	35	6

Table 7.11 Preferences expressed in comment letters for period for amortisation (years).

<u>Respondent</u>	<u>No</u>	<u>40</u>	<u>20-40</u>	<u>>20</u>	<u>20</u>	<u><20</u>	<u>10-20</u>	<u>10</u>	<u>5-10</u>	<u>5</u>	<u>3</u>
<u>Group</u>	<u>Limit</u>										
Companies	0	8	0	0	4	0	0	0	1	2	0
Accountants	2	2	0	2	3	1	0	2	2	4	0
Rep Bodies	1	0	1	0	7	0	1	1	4	5	0
Other Rep	0	0	0	0	2	0	0	0	0	0	0
Individuals	0	0	0	0	0	0	0	0	0	0	1
Miscellaneous	0	0	0	0	0	2	0	0	0	0	0
Total	3	10	1	2	16	3	1	3	7	11	1

In addition to these preferences, Director's Opinion was selected by one company, one firm of accountants, one representative body and two other representative bodies. One firm of accountants (Touche Ross) suggested a method whereby goodwill was written off with the tangible assets acquired.

Table 7.12 Preferences expressed in comment letters for treatment of non-purchased goodwill.

<u>Respondent</u>	<u>Not Included</u>	<u>Included</u>
<u>Group</u>		
Companies	5	0
Accountants	3	1
Rep Bodies	7	0
Other Rep	2	0
Individuals	0	0
Miscellaneous	<u>0</u>	<u>0</u>
Total	<u>17</u>	<u>1</u>

Analysis Of Results

The majority of all groups supported a choice of the accounting treatment of goodwill. Of those expressing preference for a single method, the majority favoured the immediate write-off. The overall results of this section would appear to hide certain theoretical preferences behind solutions to practical problems. Several of those supporting a choice of method for different acquisitions (which was not mentioned in the Exposure Draft), did so because of the problem of large-scale writing-off of goodwill where the reserves were not sufficient or shareholders funds would be greatly reduced by such an action. There was however an undercurrent of theoretical support for the immediate write-off, which followed current practice.

There was a wide divergence of opinion on the maximum period for amortisation of capitalised goodwill. The highest number of expressed

preferences was for twenty years, followed by five years and then forty years. These figures correspond respectively with the period suggested by the Exposure Draft, the period included in the EEC 4th Directive (although the UK had exercised its member state option in respect of this), and the normal maximum write-off period of intangibles in the USA. Five respondents favoured the more subjective approach of the economic useful life of the Companies Act, termed Director's Opinion.

Insofar as the capitalisation of non-purchased goodwill was concerned, the majority of respondents (17 out of 18), agreed that this was not a desirable practice. Effectively, the support for this was even stronger in that those favouring the immediate write-off of purchased goodwill are hardly likely to support the capitalisation of non-purchased goodwill.

A comparison of the requirements of respondents with the treatments allowed by the standard shows that the majority of these would be permitted to use their preferred practices under the standard. Out of 22 companies commenting on the accounting treatment of goodwill, only four expressed preferences outside of the permissible treatments. Two of these companies (both in the newsagent's business) ultimately won a special provision in the standard (para 15) effectively exempting them from applying the Standard¹⁰. Of the remaining two, their preferred treatment was to amortise through reserves rather than through the profit and loss account, there being no immediate effect on shareholders funds by this action, (also escaping a charge to the current or future profit and loss accounts). Out of the twenty firms of accountants replying to this aspect of the Draft, all of their preferences could be fully satisfied with the exception of two small firms, one of whom believed that goodwill should always be carried at cost, and the other being against any standard at all on goodwill. In the case of Representative Bodies of Accountants (22), Other Representative Bodies (5), Other (1) and Individuals (6), all requirements could be met by the standard.

¹⁰ The argument from NSS Newsagents was that goodwill was in fact included within 'Retail Outlets' and that from BPM Holdings that the goodwill element was capable of valuation and indeed could be sold separately from the business as a whole.

Insofar as the period for amortisation was concerned, by using the estimate of economic useful life in the Standard, all preferences could again be satisfied in that the preparer could use any period which he felt would represent such life. There was one innovative approach to this from Touche Ross linking goodwill write-off periods to tangible fixed assets acquired, but this could still be accommodated under the terms of the Standard. From the eighteen comments received on the inclusion of non-purchased goodwill, only one small firm of accountants felt that this should be included, the remainder strongly believing that only purchased goodwill should be included in the accounts.

From 152 expressed preferences therefore, 147 could be satisfied under the terms of the goodwill Standard.

Contemporary Practice

A survey of the accounts of three hundred UK companies again illustrates that the replies to Exposure Drafts tended to follow practice at that time.

Table 7.13 The accounting treatment of goodwill 1968/69, 1975/76 and 1982/83.

	1968/69		1975/76		1982/83	
	Nos	%	Nos	%	Nos	%
Goodwill written off						
on acquisition	84	40	135	56	192	84
Goodwill Capitalised						
and Amortised	<u>124</u>	<u>60</u>	<u>95</u>	<u>44</u>	<u>36</u>	<u>16</u>
	<u>208</u>	<u>100</u>	<u>220</u>	<u>100</u>	<u>228</u>	<u>100</u>

Adapted from 1) Survey of Published Accounts 1976, ICAEW. and

2) Financial Reporting 1992/93, ICAEW.

In adjusting the above table, goodwill shown as deducted from reserves (the 'dangling debit' method, now outlawed) has been included with goodwill written off on acquisition as the effect on shareholder's funds is the same. Insofar as the period for amortisation is concerned, earlier surveys did not cover this area. In 1982/83, of those companies regularly

amortising goodwill, the maximum periods disclosed were as follows; 1 company: 8 years, 1: 10 years, 3: 20 years, 1: 30 years and 3:40 years.

International Practice

The international standard on goodwill, IAS 22, allowed the same options as ED 30. Nobes (1992a) describes how the IASC moved from a position of favouring capitalisation and subsequent amortisation, to allowing a choice of two treatments. In the U S at the time of the issue of both the Exposure Draft and the Standard in the UK, the promulgated GAAP for the United States were the opinions issued by the APB (Accounting Practices Board). The status of these opinions was such that they should continue to be the authoritative pronouncements except to the extent that they might be altered by Statements of Financial Accounting Standards or Concepts. The relevant APB Opinions were as follows:

Opinion 16 (August 1970) Business Combinations - refers the question of goodwill to APB Opinion 17

Opinion 17 (August 1970) Accounting for Intangibles - Intangibles to be written off against income over estimated useful economic life with a maximum of 40 years. Intangibles must not be written off to capital reserves or retained earnings.

The resurgence of interest in goodwill by the ASC is attributed by Elliot & Elliot (1996) to the EC¹¹, especially the requirement under the Fourth Directive for movement towards the standardisation of annual accounts.

Contemporary Opinion

Press reports at the time of the Exposure Draft all appeared to recognise the difficulties of accounting for goodwill, without either suggesting alternatives or favouring one treatment over another. The Investor's Chronicle (1982) talked of 'two unpalatable options'. quoting the effect on acquisitions on profits and reserves of Mercantile House and Stenhouse. Carty (1984), described how lenders discounted capitalised goodwill in their decision-making and also outlined the problem of the calculation of

¹¹ Even though as already noted, the UK had exercised its' member-state option in respect of this.

return on capital employed following take-overs. The Accountant's Magazine (1982) summarised the Draft without offering an opinion, merely telling its' readers to reply direct to the ASC. The Leader in Accountancy (1982) took a progressive view insofar as non-purchased goodwill was concerned, suggesting that, if it were possible to value internally-generated goodwill, then the choices under the Draft would not be necessary. Previously, the same article had recognised the lack of authority within the Draft by describing it as continuing the dialogue 'in a way more commonly found in a discussion document' p 1.

METHOD OF OPERATIONS

Both of the standards examined in this chapter illustrate one approach to standard setting. That approach appeared to be that of satisfying the preferences of respondents at the very expense of the basic concept of consistency as incorporated in SSAP 2. In the case of foreign exchange, consistency would imply that all companies use the same method of translation (as has been the case in the US even when the single permitted method was changed). Additionally, consistency under the standard should imply the use of a single translation method for the profit and loss account. Goodwill provides even greater inconsistencies in that not only may two methods be used, but that different methods can be used interchangeably, which again would not be allowed in the case of US standards.

The options given by both of these standards appear to reflect both current practice and opinion, but could also imply that the members of the Accounting Standards Committee were divided on the issue. The working party for goodwill was also divided upon the issue of capitalisation versus immediate write-off and contributed to the compromise solution, although, as appendix 1 suggests, the working party as a whole did not exercise significant power in the process of development of the standard. However, the ASC did in fact change its attitude towards the basic accounting treatments in both these standards. Although it could be argued that the concepts of goodwill and foreign exchange are complex and therefore there could be no single solution, there are many other complex issues in accounting such as deferred tax and accounting for

inflation, and yet at times, the ASC has seen fit to provide a single treatment by way of solution.

The ASC has been described as consensus-seeking in its approach to accounting regulation. Bromwich (1985) talks of the fact that 'A consensus may result in compromise standards lacking in intellectual rigour'(p. 87). The comment letter from Price Waterhouse in respect of ED 30 underlined this deficiency, stating;

'We believe that a decision (to adopt a single method) should have been reached based on a more rigorous examination of the opposing arguments set out in ED 30'

(Comment letter dated 28.3.83, Brackets added)

Not only may the quality of standards be impaired by the search for consensus, but delays in the standard setting process may occur (Bromwich 1992). Certainly both of these standards were delayed as measured by the length of time between the Exposure Draft and the final Standard¹².

The reason for the need for a private sector standard setting body to achieve a consensus may be driven by the problem of the enforcement of standards. Without any enforcement powers, a regulatory body has to seek voluntary acceptance of its pronouncements. At the time of the ASC, the mechanism for ensuring compliance was extremely weak. Standards therefore had to be acceptable to all. As Bromwich (1992) points out;

'Without sufficient enforcement powers, it is difficult to see how a private sector standards body can avoid tempering its suggested standards so that they can achieve acceptance by those influential sectors of the community who, by being non-co-operative, could put the future of the private sector standard setting body in doubt.'

(p. 270)

The necessity to produce standards which would gain support could be seen as an almost inevitable outcome.

¹² In the case of goodwill, the original working party was set up in 1974 and the Standard issued in 1984; the initial report on foreign exchange was in 1976, with the standard appearing in 1983

'We would have preferred the Exposure Draft to recommend only one accounting treatment, but we accept that a choice has to be offered in order to gain the necessary support of users'

(Comment letter, Coopers and Lybrand, 28.3.83)

This sentiment was endorsed by Touche Ross in their comment letter.

We recognise that there is no consensus within the accounting profession as to the correct treatment of goodwill....and it is therefore very difficult if not impossible for the ASC to obtain adequate support for any single approach'

(Comment letter Touche Ross 14.4.83)

The necessity of achieving support would appear to have risen from what Bromwich sees as self-preservation: after all the alternative to the ASC would have been accounting regulation by the State which was something the accounting profession had traditionally felt itself threatened by (see Chapter 1).

It is possible that achievement of a consensus is felt to be desirable within an agency or indeed any other rule-making body¹³. Modern theory considers consensus to imply broad agreement on fundamentals including the 'rules' of the game and may incorporate the more questionable 'consensus about ends' (Smith, 1972 p. 4). Pure definitions of the word consensus tend to be contradictory, with the Oxford Dictionary (1982) using the terms 'agreement', 'unanimous opinion' and 'majority view'. Unanimity assumes that all preferences are satisfied, whereas majority only maximises some preferences. Agreement (which, when achieved by deliberation, Smith (1972) describes as the traditional view of consensus), could incorporate some form of compromise in negotiation.

It is however debatable that the ASC could be viewed as consensus-seeking, as, in the case of the two standards examined in this chapter, there

¹³ Consensus is used to describe a state of social order or cohesion and explains why society is able to exist (see for example Comte, de Tocqueville, Durkheim quoted in Partridge, 1971). This description could be applicable to a regulatory agency trying to maintain cohesion within its domain through accommodating the needs of its constituents,

existed no unanimous opinion as to how the items should be included in the accounts. Neither was there a majority view which excluded the requirements of the minority. Such agreement as flowed from the standards did not involve any element of compromise by any party other than the ASC themselves. Although consensus about means and thereby the legitimacy of the regulators might have existed, there was no consensus about ends. It could indeed be argued that regulation had not effectively taken place, but that the ASC had merely codified the existing diverse practices, through the satisfaction of its' constituents.

Some of the difficulties in achieving a single solution to both these problems may have arisen from the fact that the ASC had no guidance from an agreed conceptual framework, which could have been used as a legitimising device both for the Committee itself as well as its' pronouncements. The fact that the ASC was driven by external pressures and unable to be authoritative was recognised by respondents to Exposure Drafts.

'We therefore agree that the sacrifice of a conceptual ideal may for the time being be an acceptable price to pay in order to achieve a pragmatic solution'

(Comment letter Arthur Young McClelland Moores & Co, 25.2.81)

In addition, the agenda of the ASC tended to be driven by events. Even the most basic statement dealing with both the disclosure of accounting policies and accounting concepts was not the first to be issued. It was preceded by SSAP 1 (Accounting for the Results of Associated Companies). However, the ASB's 'Statement of Principles' commenced in 1991, are still in draft form.

SUMMARY

In this chapter two standards were chosen to illustrate the way in which the ASC operated. The outcomes of both the standards examined satisfied the vast majority of those participants in the regulatory process by following current practice and opinion. Although the approach could have been described as consensus-seeking, it demonstrated lack of a single

consensus and produced a choice of accounting solutions through regulatory willingness to compromise. Of those involved in the process of consultation, the majority appeared to be producers rather than users. In the case of the Goodwill standard, the consultations reported to the planning sub-committee on 13.3.84 were with companies having made recent acquisitions and those indicating particular problems as preparers in their comment letters (ASC 2/53/2). Nobes (1991) in his theory of the existence of cyclical patterns, suggests that managers will 'seek to maintain flexibility of practices, and also oppose the introduction of income-reducing standards' (p. 265). SSAP 22 certainly fulfils this criteria through the lack of a consistent application of accounting policies and practice by the dominance of the immediate write-off method which maximises reported income. This standard is inconsistent with the 'political costs' theory of Watts and Zimmerman (1978), which state that companies will seek accounting standards which minimise reported earnings to avoid political interference. SSAP 20 also, fails to comply with the theory, in that the use of either method of consolidation, and the choice of average or closing rate translation in the profit and loss account, cannot systematically increase or decrease profits as these will be determined by the relative exchange rates of the reporting entities.

Additionally, the ASC appeared to have been thwarted at times by one or two key players in the process. The issue of SSAP 20 was delayed from July 1982 to April 1983 by the Technical and Research Committee of the Association of Certified Accountants. The power of the Technical Committees of the CCAB members was recognised by the ASC¹⁴. Following a meeting on 10.2.83, K O Robinson reported;

'It seems that however elaborate we make the consultation period during which accounting standards are developed, ASC is not in a position at the moment to prevent a situation whereby one or two

¹⁴ Nobes (1992) also saw the accountancy bodies as potential targets for lobbying. This is evidenced by a letter from Ebling, ASC under secretary to Renshall, ASC chairman stating 'Michael Bromwich has suggested to me that, if the ASC is not prepared to 'lead' on this matter, he may raise it at a CCAB meeting, presumably in order to try to apply pressure to the ASC' (ASC 1/11/1).

voices on a Technical Committee of this kind could effectively
overturn an ASC recommendation' (ASC 2/4/93)

This demonstrates the problems of a regulatory body with insufficient powers being forced to compromises by the virtual endorsement of existing practice and opinion. Had a comprehensive or conceptual framework type of approach been taken, the ASC may have been able to produce more timely and rigorous standards.

CHAPTER 8

THE GOVERNMENT ROLE IN ACCOUNTING REGULATION

INTRODUCTION

The process of accounting standard setting described in previous chapters has illustrated the dominance of preparers¹. This study of the process has also identified the government as being a significant actor in the setting of accounting standards. To discover the reason for that involvement, this chapter firstly examines the uses made of published accounting information by the government in order to ascertain the perspective of the government in contributing to the accounting standard setting process². The interest of the government in published accounting information has, as a result of the research carried out in this Chapter, been identified as covering three separate roles, those of preparers, users and regulators. There may however be some overlap in that actions taken while assuming one role may be influenced by considerations of other roles.

Regulations and practices that apply to business organisations are not legally binding on government departments and agencies acting as preparers of accounting information. However the very fact that both are carrying out an activity called accounting, must presume some degree of commonality in operation. The presence of professionally trained accountants in departments and agencies ensures a degree of diffusion of ideas.

The second role is that of a user of accounting information. Users of corporate reports are defined by the Corporate Report as;

‘those having a reasonable right to information concerning the reporting entity.....a reasonable right to such information exists where the activities of an organisation impinge or may impinge of a user group’
(ASSC 1975 p. 17)

¹ Through the membership and financial structures described in previous chapters and through consultation procedures.

² Previous studies of the involvement of the state with accounting have ranged from the general, e.g. Sombart's Thesis in which accounting is considered a necessary pre-requisite of capitalism, to studies of conflict between standard-setters and government (Robson, 1988).

Appendix 2 compares the findings of the research in this chapter with the government's uses of corporate reports suggested by that document.

The final role is that of the state as a regulator of accounting in its own right. Since the Joint Stock Companies Act of 1844, the state has, through the Companies Acts, assumed responsibility for regulating accounting rather than allowing it to be a matter of private contract between companies and users. Nevertheless, since 1970 its responsibilities have been 'shared' with a private sector regulatory body while prescriptive rules have grown within legislation, although an acceptance of detailed rules being made by the private sector appears to be held by the state. This regulatory role could be influenced by its' perception of best practice in respect of its' preparer role, by its' needs as a user or through the use of economic consequences to achieve a policy objective.

The chapter then draws on two other sources of interaction between the government and the accounting standard setters. There are the comment letters written by government departments in response to Exposure Drafts which may indicate a policy perspective. These comment letters represent the published view of government and their content is analysed and compared with the earlier findings in this Chapter in order to suggest motives for the involvement of government. Additionally, records of meetings and correspondence between government departments and the standard setters provide a useful insight into the relationship between the two bodies and may imply more input into the standard setting process than is publicly acknowledged.

THE STUDY

In order to discover the interest of the State in published accounting information the writer carried out a series of interviews with officials from major government departments and agencies (the results of which are included in a later section³). During each interview the government official was asked how they used published accounting information. From the results it was possible to ascertain and categorise some of the underlying relationships between agencies or departments and reporting

³ The research was carried out in 1990, and tends to reflect the structure, functions and operating environment of government and its agencies at that time. As the main focus of the study is the ASC, this aligns the research with the accounting regulatory agency then in existence.

entities which determined the information needs. Most of the examples given, represent activities which are still current, although former examples have also been included as illustrations. Where, in a decisional context additional information is used, this has also been specified, in that both non-published and non-accounting information can act as a surrogate for published accounting information. The uses detailed are not an exhaustive list due to the complex structure and diverse responsibilities of major departments, but rather represent substantive examples, in order to provide a categorisation of the various uses rather than to examine decisional and informational aspects in depth.

The results of these interviews indicate the perceived interest that the state has in published accounts. An appreciation of the role as a preparer of financial information arose as a by-product of questions asked as to the user function. The results of this aspect have not been taken further in this Chapter as the adoption of those practices seen as desirable by the state is beyond the scope of this work⁴. The role played by the Department of Trade and Industry⁵ in accounting rule-making ensures that there is an on-going mechanism in place for transferring accounting technology from the business to the government sector, (although no evidence was found of technology transferring in the other direction).

The role of the state in the process of regulation has been examined in two further ways. Firstly through analysing the comment letters in reply to Exposure Drafts. Government Departments, especially the Department of Trade and Industry, have been fairly active in responding with comments. These replies have been analysed and categorised in order to discover the motives of the State in attempting to effect accounting change and to compare such motives with its' user role. Where not seeking its own direct interest as a user, it may be assumed that a Department is acting in another interest. This interest may be political, either following a proscribed policy objective or following a general notion of the public interest (which are not necessarily mutually exclusive goals). Secondly, since the archives of the ASC have been made available for research, it has been possible to examine further interaction by the Department of Trade

⁴ Generally the research indicated that the government adopted those practices and methods it saw as applicable, while rejecting those it saw as inapplicable or undesirable.

⁵ As an observer on both the ASC and ASB.

(and Industry) with the ASC, although many papers have been removed as being confidential⁶.

INTERVIEWS WITH DEPARTMENTS AND AGENCIES⁷

The Bank Of England

The Bank has no formal responsibility for collecting or maintaining data based on company accounts, but has in the past used data supplied by the DTI to study the influences on the profitability of companies, making adjustments for the effects of inflation⁸. More recently, the Bank has used a commercial database in order to monitor the performance of certain large individual companies with a view to identifying cases where companies might find themselves in financial difficulties⁹. This is not a statutory duty, but one that the Bank has taken on itself to help prevent collapse of major industrial companies. For this it has developed a Z-score model from the evidence of company failures in the 1970's. This model, incorporating a small number of key financial ratios, is used to predict such failures. Additionally, the Bank has published a series of articles on the performance of large companies and a study of the differences between performance and other ratios when measured using historical and current cost bases. Other studies carried out by the Bank have been on the behaviour of companies in such areas as debt and dividend decisions, and the co-existence of borrowing and increasing liquidity within individual companies.

For several years, the Bank has constructed aggregate statistics on the profitability of industrial and commercial companies on behalf of the Review Board for Government Contracts who use the data in constructing a profit formula for non-competitive contracts (see Ministry of Defence section). The Bank did not appear to have any direct input into the standard setting process, although the Governor of the Bank of England now has joint responsibility for appointment of the directors of the FRC.

⁶ No reason is given for the removal of these papers apart from the fact that they were deemed 'confidential'. Unfortunately, due to the way in which the archive is kept, it is not possible to ascertain their subject matter.

⁷ The background and operational details of these interviews may be seen in Appendix 3.

⁸ This work was continued by the DTI itself.

⁹ This function had developed since the oil crisis of the 1970's.

The Central Statistical Office

Since the 1940's, the Central Statistical Office¹⁰ has compiled UK National Income Accounts (published annually as the 'Blue Book') which include balance sheets, income and appropriation accounts and statements of sources and uses of funds for various sectors of the economy. These sectors consist of the public sector and the private sector which is divided into industrial and commercial companies, financial institutions and a residual category covering the activities of persons either as individuals or in certain other forms of association. For the most part, information does not come only from published accounts, because national income accounts generally measure activities within the national boundary whereas UK parents of groups of companies may present consolidated statements which transcend these boundaries and therefore adjustments are necessary. National Income Accounts use gross profit as a reasonable surrogate figure for the net output of industrial and commercial companies, but further adjustments have to be made in the case of financial institutions which tend otherwise to give misleading results. National Income accounts are therefore compiled from a variety of sources, including banking statistics collected by the Bank of England and the Board of Inland Revenue's Corporation Tax assessments. Published accounts provide information in such areas as trade credit and company investment in central and local government securities, which is not available from other sources. The Central Statistical Office used information from company accounts to check the National Income Accounts estimates it has received from other sources. This was done by use of the Business Monitor (MA3) produced formally by the Department of Trade and Industry¹¹.

Department Of The Environment

Under Section 156 of the Housing Act 1985, local authorities could sell property to the private sector. Where the sale was subject to a mortgage, the Department of the Environment had to approve the lender where the sale was at a discount. Such approval depended upon the financial strength of the lender and conditions could be imposed to improve any apparent deficiencies of the relationship between equity and debt. The practice of securitisation of mortgages caused problems in that these

¹⁰ Now named Office for National Statistics.

¹¹ Information is now obtained from alternative sources.

mortgages disappeared from the balance sheet, but were still managed by the original lender. The Department at times therefore demanded additional non-published data in order to grant approval to potential lenders¹².

Additionally, under Section 73 of the Housing Act 1985 the Department makes grants to voluntary organisations e.g. Shelter. These grants are targeted for specific areas and therefore the Department verifies the expenditure through internal non-published data, using the published data as an overall check.

There are, in addition, other ways in which the Department is involved in housing operations. Funds for grant purposes are disbursed from the Treasury to the Department and then to the Housing Corporation. Housing Association accounts must be sent to the Housing Corporation, for monitoring purposes, whereby the viability of the association is assessed (usually by reference to the reserves). Similarly, grants made to the Commission for New Towns, who in turn pass them on to the individual New Town Development Corporations are subject to the viability of the receiving organisation as evidenced by their accounts.

Department Of Health

The main use the Department of Health has for published accounts is in connection with the Pharmaceutical Price Regulation Scheme (1986), which is an agreement between the Association of the British Pharmaceutical Industry and various government departments responsible for health matters. The purpose of the scheme is to secure the provision of medicines at reasonable prices, to encourage efficient and competitive development and supply of medicines, and to encourage a strong and profitable pharmaceutical industry in the UK capable of sustained research and development. The scheme is concerned with the NHS medicines which are those brand-named medicines produced by a single supplier. In the case of generic pharmaceutical products (non brand names e.g. aspirin) it is felt that competition will eliminate excessive profits.

¹² FRS 5 has effectively overcome this problem by limiting the situations in which securitised mortgages can be de-recognised.

Each pharmaceutical company supplying NHS medicine with total home (UK) sales of over £4 million, has to supply an annual financial return in a prescribed format to the Department of Health within six months of the end of the accounting year. This return consists of disaggregated information on revenue, costs and profits. It is accompanied by an independent accountant's report and is reconciled to the published financial statements. Where a pharmaceutical company is marketing rather than producing, a separate return is completed, reconciling the audited accounts with the annual financial return. A similar breakdown is made of the balance sheet in order to make a calculation of the return on assets. There is an acceptable range for this, some four percentage points wide. Improved efficiency will increase the return, and this circumstance is acceptable to the Department. Adjustments are made where current costs are used, under the alternative accounting rules permitted by the Companies Act, as returns are based strictly on historical cost. Current ratios are used for comparison purposes between NHS and non NHS products to ensure that companies are not attempting to 'load' capital employed. Accounts of overseas holding companies are also analysed to examine, for example, the ratio of research and development expenditure to sales to ascertain a reasonable proportion of R & D expenses for the UK company.

Medium sized companies (sales of NHS medicines of £400,000 to £4 million), have to supply a certified breakdown of turnover with the audited accounts, whereas small companies are exempt from these requirements, although the Department of Health retains the right of full information disclosure. With small companies the Department may query excessive remuneration/benefits for directors and reduce these for calculation purposes.

There are no rights of access to management accounts or any internal information, but companies have always adhered to the request for information as laid down. There has been no involvement by the Department in standard setting as it feels that the Agreement is sufficiently comprehensive for their needs.

The Department Of Trade And Industry

a) Statistics

The Department of Trade and Industry formerly carried out a company accounts analysis published regularly by HMSO as Business Monitor MA3 "Company Finance". This consisted of a set of standardised and aggregated balance sheets, income and appropriation accounts and statements of sources and uses of funds together with various accounting ratios¹³. Tables were presented for the Industrial and Commercial Sector as a whole, and also for some 30 constituent industry groups based on the UK standard industrial classification of 1980. In addition to data collected on the top 2000 companies in the UK, remaining information was based on a sample of companies.

The contents of companies' profit and loss account had to be adapted to the format of the income and appropriation accounts recorded in MA3 and additionally, the sources and uses of funds had to be compiled from a SSAP which allowed a great deal of latitude in content and presentation. Since the standardised formats of the 1981 Companies Act were fully adopted, the adaptations have been easier to effect, although the right for smaller companies to file modified accounts has meant that there are fewer smaller companies on which to base any sample.

b) Grants

Formerly, the Department was responsible for overseeing grants given under Section 7/8 of the Industry Act 1972. Such grants were made in support of the development of new technology. In order to check the overhead rate, internal data had to be used; rights to such data being a condition imposed under the terms of the offer. Published accounts would be used as a final check, although this would only tend to be accurate in the case of a small company, which was involved in a single project.

The involvement of this Department in the standard setting process is covered in a later section.

¹³ At the time of the original research, SSAP 10 was extant.

Export Credit Guarantee Department¹⁴

Although much of the work of the Export Credit Guarantee Department is concerned with foreign buyers and therefore the assessment of risk based on non-UK information, there are situations where the Department uses the published financial information from UK companies. This would occur where the Department has the right to claim money back from UK companies under a recourse clause of the ECGD facility.

Before assuming any contingent liabilities, the Department makes an assessment of the solvency of the UK exporter in order to judge his ability to meet a recourse demand. A simple form of ratio analysis is used to examine trends or adverse features to identify areas for further investigation. This may lead to meetings with Finance Directors and, with the Company's approval, meetings with bankers. The right to carry out this course of action may be contained within the guarantee document. The acceptance of a contingent liability may be followed by the demand for some form of guarantee, or in rare cases, the taking of security. In this way, the Department acts in the same way as a banker when assessing a contingent liability based on a performance bond.

There has been no direct involvement by this Department with the standard-setting process.

Department Of Employment

a) Employee Involvement Section

Under Section 1 of the Employment Act of 1982, employers are required to disclose (a) how employees are informed and (b) what steps are being made towards financial participation in the firm for employees. This disclosure has to be made in the Director's Report. Where companies fail to comply, they are warned to do so and the annual report is specifically checked the following year. Where disclosure is somewhat vague and generalised, there are no powers to secure further information; only requests can be made. Companies are selected on a random basis from the Times Top 1000 and analysed on the basis of numbers of employees rather than industry types. It is felt by this Section that the 'voluntary basis' of disclosure will be maintained. The Section will also use financial reports

¹⁴ This is a non-ministerial government department.

for the purpose of generally briefing the Minister in the area of employee involvement.

b) Economic Policy Briefing Section

This section has a function of briefing the Minister on matters relating to specific companies. They use the Annual Report rather than the accounts to obtain an overview of the information about a target company, although there is a particular emphasis on both the sales and profit figures. General information disclosure on employment would tend to be ignored, only positive items would be relevant such as specific information on employee participation or the involvement of the company with a local TEC (Training and Enterprise Council).

More information where required may be obtained from other sources, such as the local Employment Department office or other concerned government departments e.g. DTI or Department of the Environment, but this information would tend to be descriptive, rather than quantitative.

There is no direct involvement of this Department in accounting standard setting.

The Home Office

a) Procurement Section

This unit deals with major areas of purchasing, and establishes a bidders list for major contracts. Potential bidders are selected, and if they are interested in proceeding, three years accounts are forwarded to the Home Office to ensure their capability in financial terms of carrying out the contract. This is then subject to ratio analysis to ensure their suitability. If these results are not entirely satisfactory, a parent company guarantee could be requested. In situations where there is no parent company, internal data can be requested to ensure that companies do not agree terms which are optimistic in such areas as future cash flows. Payments on account of supplies are fairly rare, but where used are normally covered by bank guarantees.

Where a trading relationship already exists, and suspicion about the supplier exists, the Home Office would use a commercial agency (Dun and Bradstreet) to check and report on the status of the company in order to

secure the most up to date information. Certain supplies are considered vital to some Home Office establishments such as prisons where interruptions to delivery of material to prison workshops or food could be critical. As an adjunct to using commercial agencies, a bank reference may also be sought in these circumstances. At the time of the interview, the Home Office was setting up a management information system to give a profile of supplying companies so that a more systematic check could be carried out.

External commercial agencies are also used for interpretation of European Companies' accounts where, under E C rules for compulsory advertising for tender, the Home Office has difficulties formulating opinions.

b) Voluntary Services Unit

This unit of the Home Office deals with issues relating to matters concerning the government and the voluntary sector. The government perspective arises from their role as grant givers or managers of contracts with voluntary organisations for the provision of services. Direct grants may be given from central or local government or from other bodies such as the NHS. Additionally, they may be involved in payment for either projects or services such as the provision of residential places.

Because of this, they feel that both they (and the public) should have a comprehensive picture of the various sources of income of the recipient organisations and stress the importance of distinguishing (and identifying) public sources of funding, in order to give an indication of the financial viability and future prospects of individual charities.

This is in line with current government thinking on organisational accountability, and would also fall generally in the area of public interest, in that direct funding and the tax relief granted on fund-raising activities can be seen as the grant of a public benefit.

The only direct submission to the Accounting Standards Committee, during the period was made by this section in response to an exposure draft on one SORP (Statement of Recommended Practice).

The Inland Revenue

There was, prior to 1993, no obligation for the corporate taxpayer to submit published accounts to the Inland Revenue. Where these were supplied they were forwarded to the Inland Revenue with tax computations (and/or return of profits). In the absence of this, the Revenue had powers to raise an estimated assessment. Where an appeal was made against this, published accounts were normally submitted as part of the appeal procedure. Cases were sometimes referred by the Revenue to the Commissioners for appeal in order to secure accounts and computations. Failing this, there were formal information powers available under the Taxes Management Act s 51 and s 20. However, under the 'Pay and File' system, a company is obliged to send a copy of its accounts to the Inland Revenue with its return within a specified time from the year end

The preference expressed by the Inland Revenue not unnaturally, was for accounting standards to be tax-driven. In this connection, any comments on standards are made to the Department of Trade and Industry; and therefore cannot be separately attributed to the Inland Revenue, although one direct comment was made on ED 40 of a highly technical nature concerning one specific legal case.

Ministry Of Agriculture Fisheries And Food

This Department is not presently a user of published accounts as grants made to third parties are on a quantitative basis, and thus concerned with physical production rather than being based on financial information. However, the Ministry was previously involved in two schemes which depended upon the published accounts of the recipients. The first of these was an EEC scheme for modernising agricultural infrastructure facilities such as grain storage at docks. As part of the application procedure, accounts had to be submitted for scrutiny to ensure the viability of the recipient company and subsequent checks were carried out to ensure that moneys had been properly spent. The second scheme was the Farm and Horticultural Scheme (later named the Agricultural Improvement Scheme) under which a grant was made to assist in increasing labour productivity. Accounts were used in an attempt to use income figures to check on the increase in labour productivity. In many cases, these grants were made to non-incorporated businesses and there was authorisation

for the production of accounts contained within the Statutory Instrument setting up the scheme.

No direct submissions have been made to the Accounting Standards Committee for the period in question.

Monopolies And Mergers Commission

The Commission has no power to instigate its own investigations. These usually arise from issues referred by the Secretary of State for Industry or the Director-General of the Office of Fair Trading. Once an enquiry has been put in hand, the Commission has powers to require any person to attend to give evidence or produce any relevant documents and to require information from any person carrying on any business. Initially, the Commission asks for management accounts and basic data including internal performance measures, intragroup trading and transfer pricing (Brown, 1992). The work of the Commission might be best illustrated by reference to three specific cases during the period covered by the research in this chapter.

Blue Circle Industries/Armitage Shanks (Cmmd 8039 1980). Because of Blue Circle Industries' policy of creating operating units rather than subsidiaries, the Commission recognised that there would be a post-merger information loss. They recommended that for some years after the merger, disclosure of the results of the acquired company (turnover, profits and return on capital), should be required. Under the then extant 1967 Companies Act, any analysis of types of business was to be based on a classification decided by the Directors. The report suggested that the classification should be that used by the Board of Trade (Standard Industrial Classification), and extended to include information on return on capital.

Ford Motor Company (Cmnd 9437 1985). The company was referred under S. 310 of the Competition Act 1980, forcing Ford to justify its' pricing policy for spare parts. For this exercise, product development costs were used from the published accounts, and an attempt by Ford was made to allocate these costs to that part of the business dealing with replacement parts.

The Supply of Petrol (Cm 972 1990). The major petrol wholesalers were asked to identify all sources of income from site operations and all types of costs directly arising from ownership of retail sites. In order to report, the Commission used published accounts, questionnaires on financial matters and other information supplied by individual firms and their consultants.

No direct submissions to the Accounting Standards Committee were made by the Commission during this period.

Ministry of Defence

a) Directorate of Procurement

This department uses published accounts, brokers reports and MOD internal records in order to monitor defence contractors. The Directorate deals only with macro issues, such as advising the Office of Fair Trading and the Monopolies and Mergers Commission¹⁵. There is also a role in briefing the Minister of Defence on specific companies and projects, in which context the published accounts are used to provide an overview of activities.

b) Accounting, Estimating and Pricing Services

This division consists of both accountants and engineers. For non-competitive contracts, engineers are involved with prime cost and accountants with overheads and profit rates. The rate of return on contracts is based on an agreed formula using capital employed and cost of production. These rates are agreed by the Review Board for Government Contracts which was established following agreement between the Government and the CBI, in order to ensure a rate of return equal to the overall average earned by British Industry. This requires a detailed definition of capital employed which is given by the Review Board and is computed partly using current cost information as a basis.

Under their standard conditions of contract, the Ministry of Defence may examine overheads of contractors and indeed carry out post-costing exercises on selected contracts. Published accounts are used as a guide to the financial health of an existing contractor or a first time bidder for government contracts. With smaller companies, published accounts may

¹⁵ For an example, see the GEC/Siemens proposed take-over of Plessey (Cm 676, April 1989).

be useful where the company is involved in one unit of production, but only as a device for checking costs. In the case of larger companies, segmental results would not be of use because the data would not be presented for the production unit. For the purpose of pricing, the unit may be very small in comparison to the firm as a whole. Internal data supplied under the standard conditions is reconciled, where possible with the published accounts as a check on accuracy, and any consolidation adjustments are carefully examined.

This department has not made any direct submissions to the Accounting Standards Committee in the period under examination.

Office of Fair Trading

The Office of Fair Trading is a non-ministerial department with close links (through personnel) with the DTI. The main areas of responsibility are investigation into restrictive trade practices, anti-competitive practices, monopolies and mergers. Work in the area of restrictive trade practices involves the examination of such areas as cartels e.g. product pricing, with the view of detection of super-normal profits.

In the case of anti-competitive practices, investigations are carried out in such areas as predatory pricing (the short-term reduction in prices to drive out competition). The Office examines internal data to see if, for example price is less than marginal cost. If requested information is not forthcoming, the Office may commence a formal investigation. Statutory powers for securing the necessary information are held under the Competition Act (1980). In the case of mergers, the Office examines the prior profitability of the target company and also the consideration paid for the company. As a preliminary test, this is compared with the replacement costs of the assets (if known) to ascertain the reason for the purchase i.e. is it a purchase of assets or purchase of market share? Powers to secure information are held rather vaguely under the terms of the Fair Trading Act of 1973, with S 22 giving the rights to 'collect information'.

The Office makes its own submissions to the ASC and comments were submitted on SSAP 25 (Segmental Accounting) which they felt would highlight super-normal profits and thus attract new entrants to the market. The Office has indicated that it would support the disclosure of

replacement cost accounting information in a reply to any exposure draft on fixed asset accounting. This would assist it to carry out its functions in the areas of anti-competitive practices and mergers.

The Treasury

The role of the Treasury is that of management of the UK economy, and as such, they do not appear to have an interest in the accounting statements of any one firm. Their representation on the ASC and the ASB is that of an observer, although in this role, they are also invited to comment.

They view their role in two ways; firstly to look at commercial standards and their applicability to government agency accounting and government commercial enterprises e.g. HMSO. Secondly they look at the wider economic implications of standards, although it is not possible to ascertain whether they passively identify such implications or attempt to control, or if necessary, recommend action to overcome those effects which they consider undesirable or incompatible with current policy. Any comments made on accounting regulation would go through the Department of Trade and Industry, or if made direct would have already been discussed with that Department, although in the ten years examined no exposure draft replies have been made direct by the Treasury.

H M Customs and Excise - VAT Section

The general use of published accounts is as a 'range check' of values put into VAT returns. In performing this function, accounts are more valuable in the context of output (sales) than input (purchases), as the latter will include wages and other items not subject to taxation. Additionally, tax on the purchase of fixed assets would not show up in the profit and loss account¹⁶.

Rights to inspect documents, records and information generally, are held under the VAT Act 1983, which reduces the importance of using published accounts as a prime source of information. However, due to limited investigative resources, published accounts do, in fact give an overview of where such resources are best employed. Where group

¹⁶ Although Customs and Excise did admit that detailed profit and loss accounts submitted by smaller enterprises were of greater assistance.

accounts are being examined, these can be supplemented by the inclusion of consolidation working papers.

In the case of insurance companies, the financial accounts are not used so much as the statutory audited report forwarded to the DTI. This report, by giving a breakdown of risks and type of business, allows a better range check and information on the nature of activities.

No replies have been made to Exposure drafts directly by this department.

GOVERNMENT AS A USER

From the results of these interviews, many government departments and agencies appear to use published accounting information. Within a department, different sections may have different requirements based on their individual roles. The information requirements of these departments or sections depend upon the relationship between the reporting entity and the government department. These relationships may be categorised into five distinct areas.

- * There is the trading type of relationship where the Department is a purchaser of goods or services.
- * There is the grant relationship where public funds are made available to organisations usually under a Statutory Instrument set up under Act of Parliament.
- * In order to ensure compliance with the law, the Government may use published accounting information as a way of monitoring actions.
- * Where departments are not necessarily interested in specifics, accounting data may be used to gain an overview of the organisation.

- * There is the relationship based on taxation of the organisation either from the point of view of direct taxes levied e.g. Corporation Tax or from the point of view of the organisation as a collection agent for taxes e.g. Value Added Tax.

In many cases, published information is not sufficient to satisfy requirements, and other non-published information has to be supplied. The basis for the supply of information not normally in the public domain, lies in the nature of the relationship. This additional information may be secured by legal enforcement, as a condition of the relationship, or through an industry agreement, entered into voluntarily, but binding on all parties.

Wherever a trading relationship exists, then additional information is either supplied voluntarily or through a collective industry agreement (which in many ways is an extension of voluntary supply). When giving grants, Departments are able to exact the price of additional information as a condition for the grant, either before it is made or afterwards to ensure it has been properly used. In most cases of relationships based on legal compliance, powers exist to secure any additional information. Taxation, not surprisingly, is backed up by specific powers granted under the law to enable sufficient information to be supplied for the correct tax charge to be made. The exception in the area of legal compliance is in respect of employee involvement, which might indicate a lack of commitment to this area of social policy. Where a general overview is required there are no additional powers to secure information.

The chart in appendix 4, illustrates the types of relationship mentioned above and links these to government departments. It also specifies which departments use other information and classifies the grounds under which that information is supplied

Overall it would appear that user needs of Government Departments are satisfied by published accounts, albeit supplemented by other information, supplied through the relationship of the Department with the reporting entity. During the course of the interviews, only one Department (Office

of Fair Trading) expressed a need for more information than was presently available. The Office in fact were one of the few Departments apart from the DTI, making its own comments to the ASC.

If, therefore the majority of Departments are already satisfied as far as information needs are concerned, the role of the DTI in replying to Exposure Drafts would not appear to be that of securing decision-useful information on behalf of those Departments. Their own perception of their role is detailed later in this chapter and compared with their 'public face' in making replies to Exposure Drafts as well as their actions in the regulatory process, as evidenced by the ASC archives.

GOVERNMENT REPLIES TO EXPOSURE DRAFTS

The replies to Exposure Drafts made by government departments and agencies from 1980 to 1990 have been analysed. The starting point has been chosen for two reasons. Following the change of government in 1979, any new policy effects should have been impounded into Exposure Draft replies by that time. 1980 also marks the year before the EC 4th Directive was incorporated into UK law through the Companies Act of 1981. Thus any effects of anticipating provisions of the Act should have been incorporated into both the Exposure Drafts and the replies. The final year marks the end of the ASC and the formation of the ASB. The period in question also covers most of the development period of the two standards used as specific examples in this study.

Between 1980 and 1990 twenty Exposure Drafts were issued, on which comment letters are available. Of these, government departments have commented publicly on all but three (ED 27, 39 and 47). Of the remainder, the Department of Trade and Industry have commented on all but one (ED 38). Other Departments involved in comment letters are the Home Office (ED 38). The Inland Revenue (ED 40) and the Office of Fair Trading and the Central Statistical Office (both ED 45). Although the latter office is responsible to the Secretary of State for Trade and Industry, nevertheless, their submission was made independently. A summary of the comments made is included in Appendix 5.

The general pattern of replies with the predominance of the DTI would confirm the views expressed by the departments interviewed that they

would normally submit their views, if any, through the DTI. The exceptions to this appear to have occurred where matters of extreme relevance to the department in question are under discussion, or possibly where the views of the department were different from the DTI.

An analysis of replies suggests five main categories:

- economic policy
- technical
- compliance with law
- compliance with international standards
- additional disclosure

Where a reply relates to any of these areas, the substance of such a reply may be either to endorse the Draft or suggest a change. No differentiation has been made in the analysis between these two approaches since they are both indicative of the government's motives in concerning itself with accounting regulation. Exposure Drafts leading to Statements of Recommended Practice (SORPs) have been included as well as those leading to SSAPs since the same consideration will apply to both the limited sphere of the former as well as the fundamental issues raised by the latter.

Few Exposure Drafts appear to have drawn any comments directly¹⁷ referring to areas of economic policy. Those which have, include the leasing standard (ED 29) where the concern of the DTI centred on the possible effects of the standard on the 'willingness or ability of companies to invest in productive assets' (DTI, 4.5.82) and segmental reporting (ED 45) where it was felt that due to the consequence of disclosure of results by separate economic activities 'markets will function more efficiently and competition will be encouraged' (OFT 2.5.89). There is an emphasis on exempting small companies from compliance on four separate occasions, ED's 29, 32, 45 and 46. This presumably would be in accordance with government policy concerning the encouragement of small businesses¹⁸.

¹⁷ The economic consequences would imply that all accounting proposals will have some effect. Robson's (1988) research identified in the context of the Sandilands Committee, four 'arenas', Industrial Relations, Counter-Inflation Policy, Industrial Policy and Taxation, in which accounting and the economic environment were intertwined.

¹⁸ See for example the Conservative Party Manifestos of 1979 and 1983.

However, on ten occasions, the appeal by the government has been for more disclosure. This has been separately categorised, even though such disclosure may generally be felt to increase the decision-usefulness of accounting reports. Part of the motivation for this request could be from the perspective of the state as a user in its own right, but as seen previously, this is not necessarily the case as government appears by nature of its external relationships with enterprises to receive its own set of decision-useful information. A possible reason could be the state promotion of economic efficiency (and welfare of the user groups) through allowing optimal decisions to be made with the help of increased disclosure¹⁹.

The majority of replies have included comments of a technical nature. This is not surprising given the technical content of Drafts and the fact that the communication is in many cases between accountant and accountant. Although all comments tend to be in the realms of the technical, this specific categorisation covers such areas as clarification, explanation, minor drafting changes, expansion of detail or suggestions as to alternative treatments.

Compliance with UK law (including clarification and suggested alignment of terms used) refers not only to UK Company Law, but also to company law practice as opposed to proscribed detail. This is an area where the D T I appear to be extremely active (commenting on 12 occasions), even though when interviewed they claim this as being a fairly minor role. However, major conflicts between standards and the law in the past e.g. SSAP 4 and SSAP 9 have led to revisions to the standards.

Compliance with International Standards have been mentioned on three occasions (ED's 32, 43 and 45). It may appear somewhat paradoxical that the government is reminding the standard setters (who are largely drawn from the accounting profession) to incorporate regulations developed by the profession on an international basis. Although this aspect has not been explored further in this paper, this might be an acknowledgement of the possible role of international standards in the process of harmonisation of European Law.

¹⁹ Stocks and Harrell (1995) equate increase in accounting information level with a better quality of judgement, although they conclude that groups benefit more than individuals.

The following table summarises the areas into which government's replies to Exposure Drafts fall;

Table 8.1 Analysis of government replies to exposure drafts 1980 to 1990.

E.D. No.	Topic	Economic Policy	Technical	Compliance with			More Disclosure
				U.K.Law	European Law	Int. Acc Stds.	
27	Foreign Exchange						
29	Leasing	*	*				*
30	Goodwill		*	*	*		
31	Acq. & Mergers		*	*			
32	Pension Costs	*	*	*		*	*
33	Deferred Tax		*	*			
34	Pension Schemes			*			*
36	Ex. Items & P.Y.A.		*	*			
37	Depreciation			*			
38	Charities						*
39	Pension Costs						
40	Stock & L.T.C.			*			*
41	Res. & Dev.		*	*			*
42	Spec. Purp. Trans		*				
43	Gvt.Grants		*	*		*	
44	Goodwill		*				*
45	Segment. Rptg.	*			*		*
46	Rel. Party Trans	*				*	
47	Goodwill						
48	Acqu. & Mergers			*			

THE ACCOUNTING STANDARDS ROLE OF THE DTI

The Department of Trade and Industry is one of two Government Departments with representation on the ASC (and subsequent ASB). The Companies Division of the Department has observer status, which would appear initially to involve a passive role. Within the process of standard setting, the Division sees its role as two-fold²⁰. The first of these is to communicate and sound out the views of other departments. This is carried out by way of forwarding exposure drafts to most departments for comments. Although departments are invited to reply, the process appears in practice to be one of communicating information rather than securing replies. In addition the DTI looks at all replies to Exposure Drafts (subject to time) and may seek advice from other departments or the Bank of England on specialist matters.

The Department's second involvement with standard setting is concerned with compliance with the law, but the perception of the DTI is that this is a minor role. They ensure by their involvement in the process of standard-setting, that standards comply with the Companies Act. They may be represented and operate within any working group of the standard-setting body involved with legal matters²¹. The Companies Division claims, however, that it devotes most of its resources to matters of developing Company Law, rather than involving itself with accounting standards.

Much of the involvement of the DTI with the ASC took place at meetings where the minutes do not appear in the ASC archives; nevertheless there are many references to the involvement of the Companies Division at various meetings of sub-groups. During the development of the foreign exchange standard, Jenkins, of the Companies Division attended the discussion meeting held on 14.11.79 with some 42 representatives of major companies (ASC 2/8/6). Influence by the DTI does seem to occur in that they were allowed to agree elements of the standard. It is recorded in the minutes of a meeting on 21.1.83, that:

²⁰ Source - interview with Jenkins of DTI on 19.10.90.

²¹ Where changes in company law are to be made, the DTI produces consultative documents on which it invites comments by specific dates in much the same way as exposure drafts. These documents are forwarded to those parties considered by the Department to have an interest in the topic.

'The ASC representatives explained how they had dealt with the individual comments made by the DOT²² in the attachment to their letter (dated 10.1.83) and this treatment was accepted by the DOT subject to the following minor amendments...'

(ASC 1/9/1)

Unfortunately no record of the letter of 10.1.83 has been retained, but the element of negotiation is confirmed in a letter from Pauline Wallace, (under secretary to the ASC) to J Bowman of Price Waterhouse dated 28.1.83 'In addition to the changes *agreed* with the DOT...' (ASC 2/11/2, italics added). The importance of alignment of standards with company law does appear to have been accepted some three years earlier in a letter from Jenkins (DOT) to Carty (ASC secretary) dated 7.5.80 - already quoted in Chapter 3, but also relevant in this context.

'At the very least, it will be assumed that compliance with an SSAP would not involve any risk of infringing the statutory requirements.....we think it important that the ASC should consider the treatment advocated in the proposed exposure draft in the light of the imminent and prospective statutory position in the UK'

(ASC 2/30/2)

The development of the standard on goodwill, also shows the involvement of the Department. A panel was set up as a sub-committee of the ASC to discuss matters relating to goodwill with Knox and Leeson of the DOT as members. Although minutes only exist in respect of one meeting, mention is made of 8 meetings of this panel between November 1978 and June 1979 (ASC 2/10/2). Evidence of negotiations on the terms of the proposed standard exist. In a letter dated 10.9.79 from Knox to Wild of the ASC he states;

'... I suggest that in order to maintain comparability where goodwill is carried as a permanent asset, the effect of the treatment we now recommend should be disclosed in the notes'

(ASC 2/10/2)

Comment letters on the exposure draft were sent to Knox, which confirms the statement made by the DTI during an interview with the writer that these are examined whenever time permits. Knox was also asked to check details of the legality of the proposed treatments with his legal staff

²² Department of Trade, now DTI.

(minutes of meeting of panel ASC 2/24/1), a function which the DOT later repeated through a letter from Jenkins (DOT) to Renshall (ASC) dated 26.5.82 commenting on the reconciliation of the proposed standard with the law and additionally commenting on matters of drafting (ASC 2/89/1).

The extent of governmental involvement can also be seen through records of Parliamentary answers. In 1976 in the context of inflation accounting, Dell, Minister at the Treasury stated that ,

'Government have been consulted by the accounting profession in course of preparation of the exposure draft, and endorse the approach taken by the profession.'

(Hansard Vol. 921)

The DTI not only monitored developments in the area of accounting regulation²³ , but also were pro-active on occasions as Redwood also stated;

'My Department has drawn the attention of the ASB to several points which will need to be considered when SSAP 21 is reviewed.'

(Hansard Vol. 194 9.7.91)

However, the DTI had stated that their role with regard to accounting standards is one of communication of information to other departments and receiving their comments with a secondary role of ensuring compliance with company law. The incidences of other departments responding to exposure drafts is very rare, and it is therefore difficult in the absence of the availability of inter-departmental correspondence to ascertain the amount of communication that may take place or the origin of governmental (DOT/DTI) replies to exposure drafts. In interviews with other departments, no recollection was forthcoming of comments on exposure drafts being given to the DTI. This might imply that it is the DTI themselves who are concerned with accounting standards although during an interview with the writer they tended to marginalise their involvement. This 'official' attitude is confirmed in a letter written by Miss E Llewellyn-Smith, Under Secretary of the Companies Division on 10.8.82 to M Walsh, Head of Technical Services at the Association of Certified and Corporate Accountants (ACCA) stating 'Still less would I feel

²³ This may be illustrated by a reply made by Redwood of the DTI to Austen Mitchell MP, on the subject of accounting for financial futures, in which he stated that the issue was being considered by the profession and that the DTI was watching developments closely (Hansard Vol. 194).

it the Department's role to say whether a standard should or should not apply to banks' (ASC 2/28/2). The title of 'observer' on the ASC would imply a passive role if it were not for the fact that evidence exists that on one occasion they voted on a draft standard²⁴. (Letter from K Sharp to K Robinson of ASC dated 21.4.82, ASC 2/29/3). It is not possible to say whether they voted on other occasions as the ballot results were normally disclosed only on a numerical basis.

Consultation by the ASC with the DOT was a normal part of their process of developing draft standards. This is accounted for in an internal paper produced by the ASC in 1982, which stated;

' Because of the growing impact of company law on accounting, it has become necessary to consult frequently with the Companies Division of the Department of Trade when exposure drafts of new standards or revisions of existing standards have reached an appropriate stage'

(ASC 1982)

Despite the role described above which would appear to be one of reconciling standards with the law, there were however concerns voiced at the involvement of the DTI. In an internal ASC memo from Rawlins to Davison, excess government interference from their representatives was mentioned (ASC 5/3/5).

SUMMARY

The motivation for state involvement in standard setting would appear to exclude their own role as a user. Where representatives of user groups are members of or attempt to influence standard setting bodies, their actions will generally be dictated by the requirements of information as inputs to decision models. In the case of government departments and agencies, their needs appear to be satisfied either by existing reporting practices or through their powers both formal and informal to secure additional information.

²⁴ This was explained by a former assistant secretary of the ASC as purely a way in which the ASC could confirm the agreement of government to the draft standard, although presumably implies that ASC were concerned about official opinion. In any case it does elevate the position of 'observer' and give government a higher profile than other groups (Interview with J Winters, 1995).

Involvement in the standard setting process, if not carried out from the user perspective, must have other reasons. One might be the promotion of specific policy objectives; another might be the 'public interest' aspect of maximising social welfare (although there must be a degree of overlap between these two objectives). In the case of the former, some specific policies are recognisable e.g. the concern with exempting small companies from some reporting requirements and the effect of reporting leased items as fixed assets with corresponding liabilities. In the case of 'public interest' the link is more tenuous. More disclosure may be associated with improving the allocative process through superior decision-making. Clarification of technical matters might also assist with this. The interest of the state in accounting would not appear to be a passive role of allowing reports to influence their decision making behaviour. It seems that the role is far more one of ensuring desirable results from accounting (from the point of view of the government).

It is difficult to imagine the state allowing the formulation of regulations with economic effects taking place outside the normal policy-making arena unless they can exert a degree of influence. The emphasis on compliance of standards with UK law is one area in which the state is exercising an overall control. The lack of detailed accounting rules made by the state would appear to indicate the acceptance of a framework under which the accounting profession makes these detailed rules, whilst remaining within the boundaries set by the Companies Acts. However, detailed rules have economic effects, and it is these that the state may attempt to control. Certainly the observer status of the government representatives on the Accounting Standards Committee appears to hide the influence they were able to wield. Not only does the state have the ability to institutionalise the process of standard-setting totally, but is able to influence individual issues. In the context of the revision to the Research and Development standard; '

.....the DTI observer commented that the government was keen to see the disclosure of Research and Development expenditure in the standard, but was considering the use of a statutory instrument to require disclosure, if the ASC could not agree on a suitable standard'

(Robson, 1988 p. 64)

The covert side of state pressure does not appear within the replies to Exposure Drafts which tend to state a view rather than threaten action.

CHAPTER 9

COMPARISONS, SUMMARY AND CONCLUSIONS

INTRODUCTION

The previous chapters have identified and examined those factors which would imply the maximisation of independence for regulatory agencies. These factors were considered primarily in the context of the structure and operations of the Accounting Standards Committee but were also extended to the Accounting Standards Board and the Financial Accounting Standards Board for the purposes of comparison. This chapter sets out to review some extant theories of regulatory behaviour and indicate their relevance in the area of accounting regulation, following which, the factors identified are then summarised and placed within the context of these overall theories of behaviour. Finally, suggestions for further research are made both as an extension to the work carried out in this thesis, and as areas to explore the subject matter further.

AGENCY CAPTURE

There are two main competing models of regulation. Firstly, there is the public interest model (Posner, 1974; Stigler, 1971), which as its name suggests, assumes that regulators represent and advance the interests of the public. Secondly, the political economy model 'argues that regulation responds primarily to the interests of the most powerful constituencies in the regulatory context' (Miles & Bhambri, 1983 p18). Agency capture represents the extreme form of this model. Capture theories are based on the fact that there is an inevitable interaction between the regulators and the regulated¹, which leads to the domination of the agency by the regulated so that policy making is biased in their favour (Lemak, 1985). Noll and Owen (1983) talk of the regulatory environment being populated by advocates of particular economic interests. Although this is partly due to the incentives that the regulated firms have in achieving beneficial

¹ This occurs at various points in the process of regulation e.g. formal consultation or less formally, through lobbying.

outcomes (such incentives are discussed later in the context of costs and benefits), there are also structural reasons identified by Thompson and Jones (1982). They argue that regulated firms tend to have a monopoly of supply of information, although they also accept that there may be other powerful voices to be heard in the process². The fact that there may exist a shared perception of problems (discussed in Chapter 5) could be a result of the supply of information to the regulators (Mitnick 1980).

If, however regulatory policy is made in an environment of powerful competing interests then clearly it is difficult to predict a systematic successful outcome for the regulated industries. On the other hand, the absence of differing interests from such an arena for policy-making may imply that regulators only receive an input from the regulated industry. Additionally, a weak system of accountability is identified as a potential cause of capture (Reagan 1987). Carey (in Bernstein, 1955), in the US political context, talks of a vacuum caused by the lack of presidential leadership of regulatory agencies, into which the regulated interests move, soon overcoming weak regulatory defences. Political sponsorship would appear to be one way in which agencies may withstand capture perhaps implying that regulation should become a democratic process. Bernstein (1955), on the other hand attributes regulatory bodies with strong anti-democratic implications³, because experts dominate the process. Certainly, where these experts are also members of a single profession, these implications may be well founded, since there exists evidence of the shared value elements in professional norms (Wilson, 1980). Such value elements which Jones (1995) attributes to gender, race, family and educational background, could account for perspectives shared by both the regulators and the regulated.

² The presence of such powerful voices may depend upon the incidence of costs and benefits, discussed later in this chapter.

³ As long ago as 1886 in the United States concerns were raised about the creation of the Interstate Commerce Commission in that it was felt that the railroad companies would be able to combine their power to control the appointment of the Commissioner through their use of the best legal and business talent.

An extreme form of capture theory has emerged which stated that regulatory agencies were created for the interests of private enterprise through some form of implicit compact between government and business to support the notions of private enterprise against consumers (Lowi 1969)⁴. In the context of accounting regulation, this would imply that the government and producers of accounting information control the process at the expense of the stakeholders or users of accounting information. Edelman (1964) describes the activities of regulators in these circumstances, as generally being little more than 'symbolic gestures'. Such claims are refuted by Thompson & Jones (1982) and by Wilson (1980) on the grounds that there is little empirical evidence of this occurring and that there would be no evidence of anti-industry pronouncements if this were the case.

Stigler's (1971) economic theory of regulation posited that agencies were controlled by the regulated and operated in their interests. This was refined by Peltzman (1976) in the context of coalition seeking, whereby industries, in order to avoid the rigours of the market place demanded regulation as a form of protection. The regulated firms could provide incentives to those political parties able to harness the power of the State, by the provision of resources in return for the use of this legitimate power. The exchange of favours under such a coalition as this could only take place however where regulation emanated from the state, rather than from an independent agency. Lemak (1985) describes the economic theory of regulation as being a form of interest group theory and although such theory is criticised on the grounds that it fails to explain or predict regulatory behaviour, Posner (1974) has suggested that any form of interest group theory could be consistent with empirical evidence at least up to the mid 1970's. Other critics have pointed to the moves during the 1980's to de-regulation and the fact that the practice of politics may involve attempts to shape the preferences of participants. It has also been suggested that the rise in membership and resources of consumer, environmental and other interest groups are a cause of regulatory agencies moving towards decisions that do not favour the regulated industries.

⁴ See also section in this chapter headed Iron Triangle.

Miles and Bhambri (1983) describe a model of regulation incorporating a drift towards agency capture rather than assuming this as having happened. Their rather intuitive perspective is based on the fact that they claim that neither the public interest model or the political economy model (and by inference, the economic model) 'have not been subjected to rigorous comparative study or empirical verification' (p. 19).

ARE ACCOUNTING REGULATORS CAPTURED?

There would appear to be no actual tests to see whether an agency has been captured and hence none of the theories discussed in the previous section incorporate empirical studies. Clearly, the use of agencies involves interaction between the regulators and the regulated. The latter group as discussed in Chapter 2 have every incentive to seek beneficial outcomes which flow from the economic consequences of accounting regulation. Accounting regulation has tended to be carried out within a closed arena. Previous chapters have identified that dialogues involve accountants in the regulatory body and accountants in industry and practice. The preparers of accounts have been active in supplying information to the regulators through producing reports and detailed analysis of accounting phenomena, often contained in replies to Exposure Drafts. Accountants have always been involved directly in the process and decision-making as members of the ASC and ASB, or of working parties, while still practising as preparers (or auditors effectively appointed by the preparers). Additionally, accounting theory has been utilised to justify practices in accordance with Watts and Zimmermans (1979) prognosis in 'The Market for Excuses'⁵. The weak accountability structure of the ASC, described in Chapter 7 and exacerbated by multiple demands from diffuse stakeholders would imply that the conditions existed for agency capture. Additionally, the domination of the process by the accountancy profession, whose values may not reflect those of society, makes the lack of a clear separation of regulators and regulated even more significant.

⁵ Indeed an examination of the comment letters especially in the case of the proposed goodwill standard (ED 30) illustrates the theoretical arguments used by respondents to justify (existing) practices.

The extreme form of capture would appear to apply if it is assumed that governments support private enterprise rather than consumers. The conditions for this to occur, i.e. an implicit compact between government and business could relate to the beginnings of the ASSC which owed its origins in part to lack of governmental involvement in the detailed regulation of accounting. This lack of involvement also spanned the setting up of the ASC and the ASB and is re-examined later in this chapter as the 'iron triangle' theories. One of the main arguments used against the control of the regulatory process by industry, has been the evidence of anti-industry regulatory pronouncements. In the case of the ASC, there does not appear to be any 'unpopular' pronouncements, and even where such standards were implemented with less than full support, the individual professional bodies did not seek to discipline their members for non-compliance⁶.

The issue of whether the industry wanted to avoid the rigours of the market place is somewhat more problematic to place in the realm of accounting. The motives for the setting up of the ASSC had more to do with the accounting profession maintaining control of regulation rather than allowing the government to take over that role (as described in Chapter 1). The actions of the ICAEW in its series of Recommendations would appear to demonstrate the need for guidance on matters of accounting.

Interest group theory must be relevant to a regulatory environment, but in the cases examined it was not a case of the existence of competing groups, but rather one where a single group appeared to dominate the regulatory process.

IRON TRIANGLE

A variance on the capture theme, termed the 'Iron Triangle', has been suggested which links regulatory agencies, the government and interest groups (normally the regulated industry). In the context of the older US regulatory agencies, Machan and Johnson (1983), talk of such a coalition

⁶ See Chapter 1.

exercising a 'domination of policy' (p. 3), but Wilson (1980) discounts this theory on the grounds that any such 'tight and predictable pattern of action' (p. 391) has not been evidenced in US agencies. Additionally, he considers that some relationships are bilateral (consisting of only two of the players), rather than triangular, whereas others are quadrilateral⁷, involving both pro and anti industry groups as well as the government and the regulatory agency. Nevertheless, it is apparent that some relationships exist between the regulators, the government and the regulated by virtue of the factors identified in the previous chapters. Thompson and Jones (1982) whilst denying the existence of the iron triangle, nevertheless admit that regulatory decisions (again in the US) tend to reflect the opinions of the congressional overseeing committees and favour the interests of well organised advocacy groups.

Insofar as the UK government is concerned as the possible third party in the triangle, their role is harder to define. If the ASC was captured by the accounting profession in its role as preparer/auditor, and the government actively participated in the operations and subsequent decisions of the ASC, then this would imply the existence of an iron triangle. Additionally, the government has from time to time been asked to support the accounting profession by a form of legal backing for standards. In 1984, when ED35 was issued, a meeting was held between CCAB members, the DTI and the Treasury, at which Peter Godfrey, an ASC member stated:

'We need to ask whether a statutory instrument would give general backing to standards or whether it would be just for this one. I don't think it should be the latter. It should be seen as a general statutory backing. This is against the background of detailed statutory rules.

That is, the work of the ASC would get greater statutory backing'

(Meeting 6.11.84 ASC 1/48/4)

In the event, the regulators had to wait until the formation of the ASB before any type of formal backing of standards or recognition of the standard setters was achieved.

⁷ Wilson also points to the fact that White House efforts to bring regulatory agencies under tighter control is a 'history of dashed hopes and wasted energies' (p. 391).

Even the existence of statutory backing for standards does not necessarily imply the agreement of government with each pronouncement, without evidence being available as to their co-operation or even collusion with the standard setters during the process of formation of the regulations. From replies to exposure drafts, it would appear that government was at times at odds with industry in its views on accounting standards, especially where it was seeking to pursue those economic policy ends described in Chapter 8. Additionally, instances of conflict between the government and ASC (for example PSSAP 7) or occasions on which the threat of including matters within the Companies Acts was used, imply that the iron triangle theory does not apply in the UK. The theory would perhaps tend to apply more to situations where the agency had a sponsoring government department on which it was dependant.

LIFE CYCLE THEORIES

The life cycle theory of agencies was first put forward by Bernstein in 1955 (pp. 74-102). This states that the formation of a new agency marks a period of vigorous activity by highly motivated defenders of the public interest. This follows a gestation period during which some problem in society is recognised and corrective legislation is demanded by reformers. Where the solution lies in the formation of an agency, there is often a lack of clarity in the agency's mandate. During the 'youthful phase' of its' life, although regulated groups are well organised to protect their interests, such pressures will be met by the 'aggressive crusading spirit' of the regulators. As the regulatory body matures it may find that it has no political support for its actions. The original crisis which brought about its formation has passed, the groups supporting regulation have faded away and its political supporters have progressed to other issues. Eventually, the regulatory body becomes a part of the industrial system and 'becomes more concerned with the general health of the industry, and with enjoying good relationships with the regulated groups'. Finally, in its period of old age, decline sets in with the agency '...ignored or abandoned by an unorganised public, commissions tend to play for safety in policy decisions. Passivity deepens into debility' (p. 92). Reagan (1987) interprets this as a logical flow towards capture which derives from a lack of political support accompanied by organised pressure from the regulated industry. A

similar approach is used by Luehlhing (1995)⁸ in describing a (hypothetical) cyclical situation involving three players, the public, the government and the accounting establishment. From this emerges the following theoretical constructs; crisis, public outcry, government response, accounting intervention and probation. The crisis involves an event which provokes a public outcry often calling for governmental action⁹. Either a stop-gap measure is then introduced or the promise of legislation. This is followed by a private sector action designed to pacify government officials and voters until its' own recommendations are implemented. The government then is provided with an alternative to legislation and places the accounting establishment 'on probation', assuring the public that the accounting establishment will be closely monitored. The government then has no need to take further action until the next crisis occurs and the cycle starts again.

The idea of cycles has also been used in the context of specific issues by Nobes (1991) in his paper 'Cycles in UK Standard Setting', in which he looks at five examples of accounting practice which have been the focus of 'downward force' (against standardisation) and 'upward force' (in favour of standardisation). Each example commences with a fairly high level of standardisation proposed by 'some independent minded senior professionals', before the opposing forces with their self interest move towards less standardisation. This could be equated with the 'youthful crusading spirit' described by Bernstein (1955), but applied to individual acts of regulation rather than the regulatory body itself.

If the above cyclical ideas are applied to accounting standard setting in the UK, each one would appear to describe some part of history since 1970. The problem which marked the formation of the ASSC existed in the UK with the calls for action in the late 1960's. Initially, there was implicit support

⁸ Although Luehlhing is writing of self-regulation in the accounting profession, his ideas would seem to apply to the early days of UK standard setting in which the involvement of the accounting establishment only, mimicked a form of self-regulation.

⁹ Even though accounting regulation may not be in the government domain, the public would not always be aware of this. See Hood (1979) in Chapter 6 about confusion as to responsibilities in service provision.

in that the government was quite content to leave the question of regulation to the profession as evidenced by Parliamentary answers quoted in earlier chapters. During the late 1970's and 1980's it could be claimed that the ASC had become part of the industrial system and its decisions appeared to be pro-industry, before moving into the decline stage with safety decisions being made on the grounds of satisfying the preferences of the regulated¹⁰, as illustrated in Chapter 7. Further crises in the late 1980's with the failure of several major companies could perhaps be credited with the re-commencement of the cycle through the formation of the ASB. The early years of the new regulatory body have indicated a crusading spirit with a willingness to take decisions less than popular with those being regulated¹¹. Bernstein's theories by their nature can only be descriptive rather than capable of empirical verification, but nevertheless, they do appear to indicate trends in regulation which can be noted.

The Nobes' cycle can be considered indicative of one of the problems facing the ASC. In both the examples of standards used in previous chapter, each has started off by suggesting a high level of standardisation before being forced to adopt alternative treatments by the 'downward forces'.

Luehlfiing's (1995) description of events could be related to the life of the ASC, being formed out of a crisis, to which the government would have had to respond if the profession had not acted, as described in Chapter 1. The threat of legislative action by the government receded during the life of the ASC, and indeed previous chapters have quoted frequently from official responses endorsing the actions and legitimacy of the regulatory body. The next crisis arose when it became apparent that the then current regulatory regime was unable to prevent the further crises of the late 1980's.

¹⁰ It is interesting to note in this connection that of the last four standards issued, one has been withdrawn and the others are under review by the ASB.

¹¹ FRS's have both tackled areas of creative accounting e.g. FRS 2,4,5,6 and 7 as well as providing more information for users e.g. FRS 1, 2 and 3.

THEORIES OF LOBBYING

The majority of theories of lobbying have tended to share one common perspective, that certain economic groups control a disproportionate amount of the political resources that influence the actions of regulatory agencies. This is in accordance with the political economy model described by Miles and Bhambri (1983) which stated that regulation 'responds primarily to the interests of the most powerful constituencies in the regulatory context' (p. 18). These groups by definition behave in their own self-interest. The economics approach to a political process such as accounting regulation, is also termed 'public choice theory' (see Mueller 1979) which views the outcomes of the process as being related to the relative strengths of the groups involved. From this theory may be developed various hypotheses related to accounting, such as that of Sutton (1984) who posited that preparers of financial statements were more likely to lobby than users. He based this on the fact that preparers would obtain greater income benefits from regulation than would users who in most cases were able to diversify their portfolios. Additionally, as regulation is a public good (with no exclusion of non-participants in the lobbying process), large firms would be more likely to lobby than small firms, who could enjoy the benefits without incurring the costs. Both of these propositions are certainly testable and indeed illustrated by such visible signs of lobbying as the submission of comment letters or presentations at public hearings. However, as has already been stated, lobbying may take place at many different stages and one research report suggests that the most successful type of lobbying takes place at the very inception of the item being regulated¹².

Economic theories of lobbying are not without their critics. Wilson (1980) gives examples of the failure of economic theories of regulation in accounting for regulatory behaviour¹³ based on the fact that economists do

¹² Van Lent's (1996) study into the case of financial conglomerates in the Netherlands, identified non-public lobbying occurring very early in the regulatory process. This would be in accordance with the ideas of both Sutton (1984) and Lindahl (1987).

¹³ For example where price reductions have been ordered or where competition is allowed to enter the market.

not consider motives in non-market relationships, neither do they consider the formation of heterogeneous coalitions. Preferences are assumed in economics to be given, whereas politics often focuses on efforts being made to shape preferences. Within a political context, the shaping of preferences is one way in which coalitions are formed. Decisions are made often on the basis of the distribution of costs and benefits: however these are often non-monetary and the values assigned to them depend upon the beliefs of the participants and these beliefs may change over time.

Wilson (1980) has identified four types of political scenarios which describe lobbying behaviour in situations where costs and benefits occur. The first of these he terms majoritarian politics in which all or most of society expects to gain and all or most of society expects to pay. In this situation, because no small segment of society can expect to gain (or lose), there is little incentive to form an interest group. Within an accounting context, this could apply to a new regulation which brings information into the public domain which is non-prejudicial to those companies reporting and where the costs of production might involve passing a small cost to the product or service being produced.

The second type occurs where both costs and benefits are narrowly concentrated and is known as interest group politics. Each side has a strong incentive to organise in order to influence the regulation. Where preparers of accounting information are concerned, they may be considered in themselves as a narrow group for whom certain accounting rules could produce either costs or benefits. In the case studies contained in earlier chapters it was seen that companies preferred flexibility in accounting rules (probably from the point of view of producing beneficial consequences for themselves). Sutton (1984), using the work of Olson (1965), suggests that because of homogenous economic interests, producers can create a temporary form of organisation for lobbying purpose and that this cost-sharing exercise ensures that the cost of lobbying is outweighed by the benefits. The lack of apparent user involvement in the process of standard setting would imply that there is no narrow grouping on whom the opposing costs or benefits would accrue, for if such a group existed among users, it would be seen to be lobbying for its' preferences.

The third type, client politics, would appear to be the most likely in accounting terms. Under this, 'some small easily organised group will benefit and thus has a powerful incentive to organise and lobby' (Wilson, 1980, p. 369)¹⁴. The costs are spread over a large number of people who have little incentive to organise in opposition. As the participants in the lobbying process are in most cases members of the CCAB bodies (see Chapter 7), and moreover in nearly all cases include the 'big six' firms, they might be termed in general an organised group even though they may be fragmented by their involvement with firms, district societies or technical advisory committees. Sutton (1984) considers that lobbying will be concentrated on those producers on whom the effects of a standard are likely to be the most significant, since unlike (investors) users, they draw their income from only a few sources and are therefore unable to diversify. This may account for the dearth of users in the process.

Wilson's final category of entrepreneurial politics, involves general benefits at a cost to be born by a small segment of society. In accounting terms, this could be a disclosure of an unpopular nature (e.g. external costs imposed by the organisation). The incentive to organise against the matter is strong for opponents and weak for beneficiaries, which might imply that disclosure proposals of this sort are rarely successful for users. To succeed, they need a skilled entrepreneur who is able to mobilise public sentiment and associate the policy matter with widely shared values¹⁵. Often such entrepreneurs use allies inside the government or regulatory bodies and may be aided by a scandal or crisis. The creation of the ASSC could almost be considered an example of entrepreneurial politics in which the public was persuaded of the need for more regulation. This depended 'heavily on the attitudes of third parties' Wilson (p. 371) and the press attacks on accounting described in Chapter 1 might have acted in this way to help create an attitude of mistrust in the public. Perhaps the main examples in the UK are those of the various attacks on the audit profession in the

¹⁴ The costs of regulation are likely to fall on the producers (Francis, 1987); therefore they will benefit from opposing the regulation.

¹⁵ Perhaps the best known example of such an entrepreneur was Ralph Nader in his instigation of the Auto Safety Act of 1966 in the US.

sixties by Professor Stamp and more recently the alliance between academics and an opposition politician¹⁶, but it would be difficult to claim that these incidents mobilised public sentiment.

Wilson summarises these types of politics by stating that in client and interest group politics, the economic interests of the key actors are both clear and decisive, whereas with majoritarian and entrepreneurial politics such interests are not decisive. He therefore considers that a complete theory of regulatory politics would require a study, not just of interests, but also of beliefs. This reflects one of the deficiencies of research into accounting regulation, which appears to have concentrated on the economic interest (expressed or assumed) of the various actors, rather than their beliefs.

The dearth of empirical research on lobbying is reflected by the fact that theories tend to be descriptive rather than analytical or predictive. According to Grant (1989)¹⁷ this is explained by methodological problems which prevent a clear answer to the evaluation of interest group effectiveness. This uncertainty he compounds by describing the difficulty in identifying whether lobbying action or some other behaviour brought about success. Claims of effectiveness of lobbying have often been made post hoc and are based on self interest, (Rush, 1990; Jordan, 1991; Grantham, 1989¹⁸).

INDEPENDENCE REVISITED

Throughout this work, the accounting regulatory body has been the centre of the focus. An independent body is a necessary condition for independent decisions. The importance of this is underlined by the Chairman of FASB, Beresford (1995);

¹⁶ Sikka, Puxty and Willmot, and Austen Mitchell M P.

¹⁷ Grant's work, although in the field of public policy, can be equally applied to accounting regulation which, through economic consequences allies itself to public policy.

¹⁸ The motives for these claims could be attributed to the growth in commercial lobbyists, see for example Moloney (1996).

'The independence of the standard setter and the neutrality of the standards are critical to the credibility and reliability of reported information. Without independence and neutrality, financial reporting can become propaganda' (p. 61)

The subtitle of this thesis i.e. structure, process and inputs, describes those characteristics as the most important elements impacting on independence. The threats to independence come from those groups who wish to gain some advantage from the results of regulation, but who nevertheless must be included in the regulatory process. The very role of accounting in society makes it vulnerable, because as Robson (1994) claims;

'...accounting is called upon to legitimise, respond or change in accordance with the policy, discourses and rationales of a variety of state, industrial and labour institutions.' (p. 78)

Belkaoui (1985) considers that in the US, the activities of these interest groups has led to more politicisation of the standard setting process. Indeed, this has been recognised by FASB in the following statement:

'The process of setting accounting standards can be described as democratic because like all rule-making bodies the boards' right to make rules depends ultimately on the consent of the ruled. But because standard setting requires some perspective, it would not be appropriate to establish a standard based solely on a canvas of the constituents. Similarly, the process can be described as legislative because it must be deliberative and because all views must be heard. But the standard setters are expected to represent the entire constituency as a whole and not be representatives of a specific constituent group. The process can be described as political because there is an educational effort involved in getting a new standard accepted. But it is not political in the sense that an accommodation is required to get a standard issued.'

(FASB, 1977, quoted in Belkaoui, 1985 p. 11)

It is the representation of the community as a whole in conjunction with some perspective¹⁹ that may be the key to regulatory independence. But accounting regulation takes place in an arena of competing interests. The regulators must somehow consider the views of all groups whether participant or not in the process, especially as Fogarty et al (1994) point out, incentives and victories of specially interested parties, runs counter to the public interest. The threats to independence were seen in the earlier chapters to arise from two separate sources. The producers of information and the government. Adding to, and also underlying this threat is the absence of users in the process to balance other more powerful interests.

The larger corporate producers of information are normally those who are expected to lobby. In part this may be due to the type of individual cost-benefit analysis described by Olson (1965) or because lobbying is 'concentrated among those producers on whom the "real" effects of a standard are likely to bear most heavily' (Sutton, 1984, p. 86). Additionally, lobbying efforts are thought to be dependent upon the resources at the lobbyists' disposal (Becker 1983, Blake 1973). The research into SSAP20 and SSAP22 showed that it was the large firms which submitted comment letters and made presentations (possibly because both standards concerned the activities of large-scale operations). Nobes's (1992[a]) comment 'As usual users were hard to detect' (p. 156) could apply to both of these standards. Beresford (1993) noted not only the dearth of users, but the fact that many producers presented themselves as users. Sutton's (1984) analysis of ED 18 also found preparers 'hidden' amongst 'individuals' and 'representative bodies' thus creating the false impression of a more rounded input into the standard.

The impact of government on the process of regulation is best illustrated perhaps by an examination of certain regulatory incidents. Traditionally in the UK, the government has publicly supported the idea of private sector accounting regulation and parliamentary answers quoted earlier affirm this principle. As seen in previous chapters, consideration has been given at times to the legal endorsement of accounting standards. On the other

¹⁹ Perhaps the perspective might be based on some form of social consensus and found within an agreed conceptual framework of accounting.

hand, threats of the use of company law to overcome shortfalls in disclosure requirements revealed in Robson's study of SSAP 13, imply willingness by the government to interfere in the process with the justification of acting in the national interest. The setting up of the Sandilands Committee following assurances some eighteen months earlier from the DTI that inflation accounting policy should be left to the accounting profession, is another well documented example of such interference (Robson 1994). In the US there are examples of companies approaching government in order to achieve their own objectives. Beresford (1995) quotes the case of accounting for stock options which resulted in FASB receiving 'dozens of letters from individual Senators and Representatives asking us to explain and defend our proposal....and even our existence" p. 56²⁰. It hardly seems likely that politicians should suddenly become interested in accounting principles without some form of outside pressure being applied. The decision by FASB not to require expense recognition for stock options may well have been based on the Board's self-preservation rather than accounting theory²¹. It is difficult to say whether similar pressures were felt by the ASC during its lifetime, but the removal of many of the government papers from the ASC archives could imply attempts to hide the amount of influence that was exerted, possibly by the threat of sanctions.

Within this scenario of producer and government pressure on regulators developed throughout the earlier chapters, the characteristics of the independence model all point to diverse influences on accounting regulators. A government has every incentive to allow regulation to remain in the private sector for the reasons examined in Chapter 3. Some of their motives were seen to apply to efficiency considerations, whereas others were based on political considerations. If the former motives are

²⁰ Even President Clinton was involved stating 'that it would be better to avoid legislation on this issue' and 'it would be unfortunate if FASB's proposal inadvertently undermined the competitiveness of some of America's most promising high-tec companies'.

²¹ This represented a clear theoretical climb down on behalf of FASB who admitted that '...the Board acknowledged that there simply isn't enough support for the basic notion of requiring expense recognition, even though it remains convinced that options have value and are compensation' Beresford (1995) p. 60.

the strong reasons for private regulation, then it could be assumed that interference from government will be minimised. On the other hand, where sensitive issues are concerned, or unpopular decisions are to be made, then the government may wish to use the regulatory agency to promote its preferred policy. Nevertheless government has the opportunity to influence the process not only in the same way as any other user or preparer, but also by the threat of legislation, which, although rarely used, could in any case act as a deterrent to the regulators.

The nature of the tasks undertaken by regulators can also be seen as a cause of possible interference, because the regulatory tasks overlap with those carried out by government, causing interaction and possible conflict between the two parties. Both in government replies to Exposure Drafts and in minutes of meetings between the ASC and the Department of Trade and Industry, company law considerations were used as arguments for influencing ASC members.

Funding structures are significant in that an industry funded organisation must inevitably be seen as little more than a mouthpiece for the industry, charged with publicising and legitimising its activities. Similarly, if funding had come from government, then the regulatory body might be seen as little more than the extension of a government department. The move away from CCAB funding since 1990, may be seen as an attempt to overcome this problem, and it could be suggested that the supply of funding from a variety of sources ensures that no individual contributor is able to influence the regulators. Additionally, the fact that formerly in the case of the ASC, the same individuals were involved as both producers and regulators of accounting information, implied that no standards would be issued which were harmful to industry, a fact endorsed by the limited study in chapter 7. The 'insulation' of at least a significant part of the personnel²² of the ASB could be seen as a conscious move to avoid this situation.

²² Through the appointment of a full-time chairman and technical director of the ASB.

During the lifetime of the ASC, accountability was internalised, in that the issue of standards and subsequent enforcement remained within the profession. Dependence on the CCAB for agreement on standards meant that the ASC had no authority of its' own, a situation exacerbated by the fact that the funding also came from the CCAB. The ability of the ASB to issue standards in its' own right, removes the former dependence on outside bodies. An acknowledgement of various stakeholders among users would suggest less accountability and more independence for the regulators, in that as Chapter 6 explained, multiple demands tend to weaken accountability²³.

In looking at the process of standard setting in the cases of SSAP 20 and SSAP 22, the changes made to the standards undoubtedly weakened their effect and allowed preparers to choose accounting solutions of their choice. The domination of the process by preparers, both within and without the regulatory body was identified and would account for the 'weakness' of the standards. Although lobbying would always tend to be dominated by producers of information for reasons outlined earlier in the chapter, nevertheless, the tendency may have been counter-balanced by more users within the regulatory body. The government was identified in Chapter 8 as more of a major player than it would admit, claiming a very minor role in the process while apparently having a policy-orientated concern for accounting standards and in the case of the two standards studied, being involved in many of the stages of development.

FURTHER RESEARCH

Within the area of accounting regulation, the amount of research still to be done appears infinite. The role of accounting in society means that regulation may have a widespread behavioural and allocational effect on both producers and users of accounting information. Each single act of regulation should have some consequence, otherwise, as Gellein (1978) points out, there would be little point in promulgating the item. If it is the regulatory body that is being studied rather than their pronouncements, then it is the interaction with their constituents and other stakeholders which assumes importance.

²³ This assumes that stakeholders are not a homogeneous group.

In the case of lobbying, studies have tended to rely on analysis based on comment letters. It is not that this is the best media to study; in most cases it is the only available media. As Lindhahl (1987) points out, comment letters are a low cost form of lobbying, but are unlikely to capture the extent of the total lobbying. Indeed, Fogarty et al (1994) go even further by stating that the research carried out to date in '...conducting primitive counts and classifications, raises more questions than it answers and has not even exhausted the capabilities of what must be the first step in content analysis' (pp. 40, 41). In order to gauge the extent of lobbying, detailed interviews would have to be carried out with all members of the regulatory body. Documentation (if it existed) which would detail all written submissions and minutes of meetings with interested parties would have to be examined. Such detail would furnish the researcher with the extent of both formal and informal lobbying and the possible revealed preferences of those carrying out the activity. These preferences could then be compared with regulatory pronouncements in order to see whether there was any form of systematic matching. This type of research would need to rely on the supply of written documentation as well as the willingness of the interviewees to supply honest answers. Although a form of matching was carried out by Tonkin (1983), this relied substantially on comment letters. Thus results might have been obscured by any form of interaction carried out in another arena.

A more focused approach which is complementary rather than an alternative to the above, is the use of case studies centred on specific acts of accounting regulation. Such studies could be used as a vehicle for testing certain hypotheses e.g. the Sutton types of hypothesis concerning size and identity of the lobbyist; the role of the auditors' preferences for accounting complexity (Watts and Zimmerman, 1986), and the Becker (1983) hypothesis which suggests a positive correlation between resources used in lobbying and success in terms of regulatory outcome. The case study suggested would need a qualitative approach consisting of the use of archival material, other published information and interviews with regulators and interested parties amongst the regulated²⁴. Thus a history of

²⁴ This is the approach used by Van Lent (1996) in his study of financial conglomerates in the Netherlands.

the development of a standard could be produced against which hypotheses could be tested and an explanation of the regulatory outcome obtained.

Such a study as this could also be carried out using models of political systems, which analyse the inputs to political demands and then examine the conversion of such demands into outputs. The models developed by such writers as Easton (1965), are somewhat complex and are often applied to a multi-demand environment and incorporate the effect of political outputs on subsequent behaviour. These models commence with the shaping of wants into demands and progress through to the final output (incorporating behavioural responses over time). As a multi-stage system, it is capable of being broken down into individual stages for research purposes. For example, the focus might be on how firms formulate responses to Exposure Drafts and the basis of their demands e.g. ideology, expectations, motivation. The political system itself then converts inputs to issues and selects certain of these issues to outputs. This action might describe the way in which an agenda for regulatory pronouncements is decided upon²⁵. Alternatively, the latter stages of the model could be examined by research into how the behaviour of regulators is shaped over time and the way in which outputs feed back into further regulatory demands²⁶.

Another area which focuses research on the regulatory agency has been suggested by Sutton (1984) in what he describes as a political economic approach. Drawing on the ideas of Noll (1974), he considers that the way in which the accounting rule-making body measures its success qua standard setter would offer promise as the basis for a theory of accounting regulation. This might be achieved by comparing the regulatory pronouncements with the original mandate given to, or assumed by the regulators. Unfortunately, such mandates often include non-specific terms such as 'public interest' and therefore may be unable to provide a standard against which outcomes can be measured. If a conceptual framework is

²⁵ Daley and Tranter (1990) suggest that the order in which accounting issues are tackled by a regulatory body is an important political decision.

²⁶ Two examples of the Easton model are included in Appendix 5.

considered to be representative of the public interest, then it may be possible to compare standards with such a framework, although this may suffer from subjective interpretation of certain of the terms used²⁷.

Fogarty et al (1994) suggest an approach based on the role of power in standard setting, not only in the contexts already mentioned in this section, but also in the context of conflicts between the 'role of the large public accounting firms as the enforcers of accounting standards and their client service to the preparers community' (p. 40). They also suggest that given the available written material i.e. comment letters, statements of position and final drafts, these should be subject to 'greater examinations in the traditions of rhetorical analysis' (p. 40), although once again this may suffer from subjective interpretation.

Inherent in most of these studies are the beliefs of the various participants in the regulatory process. Further research could concentrate on the individuals involved and include a study of their beliefs²⁸. During the recent (1996) public hearing on the subject of goodwill, Professor Tweedie of the ASB asked one presenter whether his proposals on a certain accounting treatment were based on conviction or convenience²⁹. If the lobbyists could be persuaded to give an honest answer to this question, then this would reveal the motives behind actions and explain the reason for the pressure being exerted on the regulatory body. Similarly, research which is centred on the regulators themselves and their beliefs may well assist in the explanation or prediction of actions. Perhaps this could be expanded into the area of non-participants in the process, which would involve identification of those having some potential interest in the topic under discussion to discover the reasons for non-participation³⁰.

²⁷ For example 'relevance', 'reliability' or 'materiality'.

²⁸ Wilson (1980) identified the lack of studies into beliefs as a research deficiency.

²⁹ See the Times of 28th September 1995: 'So Many Brands of Opinion on Goodwill', R Bruce p 32.

³⁰ In the early days of this research, the writer interviewed an official from the TUC who stated that the reason that no replies were made to Exposure Drafts was a shortage of resources which they felt were better utilised in lobbying the EU.

A wider perspective on research into regulation could be a comparative study. The accounting regulation 'independence' model developed in this study could be utilised in two different ways. Firstly, it could be tested on an international basis in those countries where private sector accounting regulators operate. Although the US has been widely quoted (due mainly to the availability of information, the quantity of research and the tradition of regulatory agencies), few of the elements of the model appear to have been used to apply to FASB. In other countries, such as Australia and Canada, although accounting standards have legal backing, they nevertheless are developed in the private sector and therefore could become the focus of this type of analysis.

Secondly, the work having been developed from general theories of regulation and examples of other regulatory agencies, should be capable of being transported beyond the boundaries of accounting. Regulatory agencies created by the privatisation of UK utility companies and also set up by the Financial Services Act, as well as being used for comparison purposes in earlier chapters, would provide fertile research topics. Matching the elements of the model developed in earlier chapters against other agencies should not be difficult. Motives for incorporation require a historical perspective while tasks, funding and personnel require observational techniques. Process which included the inputs can also be observed by using one or more of the approaches used in these earlier chapters. The widening of the research paradigm in this way could lead to the formulation of a more robust model.

If, as has been suggested by many accounting commentators, accounting regulation is a political activity, then it would seem reasonable that it could be subjected to the same analysis as political activity within a government setting. Self (1985) defines four major theories of government which could be used as a construct for further research. Public choice theories have already been mentioned under 'lobbying' and there is a fairly clear mechanism for examining public choice in this particular context. Pluralism 'analyses the growth and influence of groups and organisations, both public and private' Self p. 163. Research based on pluralism must examine those involved in the regulatory process both within and without the regulatory body and suggests the decline in

importance of bodies which might speak for more general interests. This would appear to be true in the area of this study. Corporatism possibly provides a fertile ground for future studies and its' relevance is illustrated in the way in which professional organisations and government appear to be significant players in the regulatory scene. Self's final area, that of bureaucratic theories tend to be more problematic in application to accounting regulation, but might be applied more if a study was being made of, for example, company law amendment, in that its' subject area concerns inefficiencies deriving from the growth in government and the reduced role of political leadership³¹.

REFLECTIONS

The originality of this study arises from several sources. In the first instance, the research has been based on a branch of political theory, the literature of which is mainly from the US, which could preclude many potential researchers from easily being able to discover and utilise the theories and concepts, since the typical background of the accounting researcher may not be within this field. The 'newness' of private sector accounting regulation, commencing in 1970, means there is not a tradition of study of accounting regulation, with research methods which could be applied to this area. Additionally, there is also the problem of the availability of information. It is only in the last three years that the ASC archives have been opened for research. The early days of the ASC were somewhat clouded in secrecy, in that even lists of ASC members were not publicly available at the time. Such due process as there was could not be said to be general knowledge³².

Even given the availability of the ASC archives, research work is not easy. The archive consists of approximately 950 files and microfiche records. These have not been stored in any rational order. Originally when the ASC was administered by the ICAEW, they used the standard Institute

³¹ It might also be considered somewhat outdated in view of the increase in privatisation and the use of agencies by governments in the 1980's and 1990's.

³² My research of the archives failed to find evidence of what could be termed 'due process' in the true sense of the expression.

method of filing at that time. There were several changes in methods over time. Although some files are dedicated to just one subject, many files contain a mixture of topics, some administrative and some technical. The index to the archive was not compiled by anyone with a technical accounting background or detailed knowledge of the ASC. Therefore there is often very little logic or indeed sequential date order in the files. The difficulties in following through a particular item is compounded by the fact that the host institution of the archive, The John Rylands Library of Manchester does not allow more than one file to be accessed at a time. Thus any attempt to follow a particular issue tends to be painfully time-consuming and often fruitless in view of the inaccurate indexing as already mentioned. These difficulties may be seen by reference to Appendix 6 which contains a report written by J Winters, a former under secretary of the ASC.

The identification of so many topics for further research tends to typify my achievement in the work for this thesis. A personal evaluation of my contribution to the study of accounting regulation could be that it represents only a pilot study or a starting point for further research into the regulatory process. The 'independence model' is not capable of indicating regulatory dependence or independence whether applied within an accounting or alternative context. What it is able to do is to indicate which factors should or should not be present if regulatory independence is to be achieved. Therefore the factors are indicative of a movement along a scale, moving the agency towards or away from independence.

As a pilot study, this thesis would mark not the end of research on the subject, but a signpost to the beginning of more detailed research. The choice of where to progress this study is therefore somewhat difficult, but could be guided by my knowledge of the availability of data. One area which I would be interested in progressing, would be a study of the particular methods of lobbying on an accounting standard. As previously identified, much of the lobbying effort is invisible and therefore it would be necessary to interview those members of the regulatory board to identify these hidden forms of lobbying and subsequently those who are carrying out the lobbying. This would be more applicable to a new

proposed standard than an existing standard as it would be difficult to unearth the hidden lobbying on a standard that had already been issued. This would require the co-operation of the ASB, who although not allowing access to any files for research purposes, have during my dealings with them, always been prepared to answer queries. From a study such as this a further understanding of the process of regulation could be gained.

Another 'next step' in research could be to test the various life cycle theories of agencies, looking at the 'tightness' of standards developed during the life of the ASC and recommencing the process with the formation of the ASB. The technique to be used would be similar to Nobes (1991), utilising exposure drafts and published standards to demonstrate (tentatively) that industry orientation occurred during the life of the agency.

Overall, during the years I have spent on this thesis, I have become familiar with the regulatory process and knowledge of the actors and the actions of the ASC. Attempting to match this with the extant regulatory theories has enabled me to develop the background (and confidence) for carrying out the further research detailed in this chapter. Despite the fact that the thesis does little more than explain the factors which may relate to regulatory independence, nevertheless this provides an essential basis for furthering my research work in this field.

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APPENDICES

Appendix		Page
1	WORKING PARTY FOR ED 30 (ACCOUNTING FOR GOODWILL)	243
2	GOVERNMENT AS A USER AND THE CORPORATE REPORT	246
3	INTERVIEWS WITH GOVERNMENT DEPARTMENTS	248
4	DEPARTMENT RELATIONSHIPS WITH PUBLISHED ACCOUNTS	251
5	EXTRACTS FROM GOVERNMENT DEPARTMENT'S COMMENT LETTERS 1980-1990	252
6	EASTON'S MODELS OF POLITICAL SYSTEMS	260
7	LETTERS FROM J WINTER	261

APPENDIX 1

WORKING PARTY FOR ED 30 (ACCOUNTING FOR GOODWILL)

The goodwill working party set up in 1978 consisted originally of Renshall (Peat Marwick), as chairman appointed by Watts, the ASC chairman, Black (Thomas Tilling) and Leeson (Whinney Murray), none of whom were ASC members at the time (although Renshall subsequently became Chairman. Subsequently, the panel (as the working party was known) was expanded to include Knox (DTI) and Westwick (Arthur Anderson).

Their views changed over time in that the original suggestion made by way of a discussion paper was that all goodwill should be treated as a fixed asset and amortised. Within one year they had realised that there was no consensus for this treatment and recommended an immediate write-off against distributable reserves. In July 1981, the panel met to make further recommendations, but of the 4 members present, 2 favoured a choice of either method, one favoured capitalisation and the other immediate write-off. The minutes to that meeting ended with the words 'In the light of the uncertainty described above, no date was fixed for the next meeting' (ASC 2/9/4). The subsequent meeting in September 1981 reflected the final approach taken by the standard 'The panel seeks ASC's authority to work towards a compromise solution which falls between the two alternatives' (ASC 2/9/4). The ASC agreed to this solution in a letter to panel members dated 18.9.81 (ASC 2/47/1).

Following this, it appears that the tasks of members of the working party was mainly that of drafting and later, following the issue of ED 30, the consideration of comments received. A suggestion was made at the time (ASC 2/61/2) that working party members could be used for meetings with companies, but there is no record of whether this was progressed.

Holgate, as under secretary to the ASC, also served as secretary to the working party, and it appears that he was very much at the centre of decision-making. There are examples of his taking a leading role in certain matters. On 21.1.82, he wrote to the working party members:

‘Although our discussion at the last meeting was inconclusive, I have amended the material on negative goodwill. I have suggested that...’
ASC 2/39/1

In a further memo to the working party members dated 30.7.82, he suggests:

‘sending out the ballot draft today enables it to be voted upon by the old ASC membership. I am sure you will appreciate that this has advantages’¹
ASC 2/61/1

It is also possible that his input into drafts was considerable. The minutes of a meeting on 28.6.83, states that :

‘No decision was taken on the question of whether a company could use both immediate write-off and amortisation at the same time’
ASC 2/61/2

and yet three days later, he writes to working party members, informing them:

‘I have deleted reference to whether a single policy should be selected and followed’
ASC 2/61/2

This appears to have been endorsed by the working party at a meeting of 10.1.84 when the question of wording was left to Renshall and Holgate. The same two members appear to have agreed on other points. In reply to a letter from Findlater (a newly appointed working party member) dated 16.3.84, Holgate writes

‘We discussed this point, but decided not to make any change’
ASC 2/61/3.

The ‘we’ refers also to himself and Renshall. A similar letter was written to Leeson regarding another point on the standard.

¹ This was significant in that 18 ASC members had terms of office termination on 31.8.82.

It would appear that not only were the working party members representatives of preparers rather than users, but they were over-ruled by the main ASC committee members.

APPENDIX 2

GOVERNMENT AS A USER AND THE CORPORATE REPORT

The Corporate Report mentions specifically that the interest of Government in published accounts of companies is as follows;

'.....information to estimate the effects of existing and proposed levies and other financial and economic measures.....

to estimate economic trends including likely balance of payments figures.

....to promote economic efficiency.

... as a potential or existing customer or finance creditor'

(para 2.33)

The findings of this paper are consistent with some of the above statements in that the work of the Central Statistical Office provides a basis for economic estimates. Certainly the Treasury has expressed an interest in the economic implications of accounting standards while the Department of Trade and Industry has demonstrated this by their replies to Exposure Drafts under the heading of economic policy in the analysis (which may be assumed to include the promotion of efficiency). Government's role as a potential customer or finance creditor is illustrated in the sections on the Department of the Environment, Department of Health, Home Office, Ministry of Agriculture Fisheries and Food and the Ministry of Defence. This supplier/customer role, it may be assumed, would also apply to the majority of Departments as well as those individually interviewed.

The Corporate Report continues with the uses of information as;

- (a) Assessing the effectiveness of the entity in achieving objectives established previously by society.*
- (b) Assessing the capacity of the entity to make future re-allocations of its resources for social purposes.*
- (c) Evaluating the economic function and performance of the entity in relation to society and the national interest and the social costs and benefits attributable to the entity.*
- (d) Attesting to compliance with taxation regulations, company law, contractual and other legal obligations and requirements'*

(para 2.35)

With regard to section (a), the activities of the Office of Fair Trading and the Monopolies and Mergers Commission, would appear to agree with this in respect of economic policies and additionally the Employee Involvement section of the Department of Employment would apply to an area of social policy. Sections (b) and (c) are extremely general and it may be assumed that this use occurs through the overview of companies carried out by the Department of Trade and Industry and the Treasury. Section (d) underlines the function of the Inland Revenue and Customs and Excise, whilst the monitoring of obligations would appear to be a function carried out by all Departments entering into contracts involving performance.

APPENDIX 3

INTERVIEWS WITH GOVERNMENT DEPARTMENTS

These interviews were carried out at an early stage in the period of registration for a research degree. At that time no particular focus for the thesis had been established and the writer was looking generally into the needs of users of financial reports and accounts. Ultimately, from the results, it became apparent that the government's interest in such publicly available information might be different from that of other users. Arising from the research carried out here, it became apparent that the government had an economic policy orientation in commenting on proposed accounting standards. This led eventually to the idea of an examination into the independence of accounting regulators.

A difficulty arising from the stage at which this research was carried out, was the inexperience of the writer, who was not aware of the existence of The Civil Service Year Book, which could have been used for securing contacts within government departments. Instead a general letter was written to the Information Office at each department explaining the background to the research and requesting an interview with a member of the department. Twenty two departments and agencies were contacted, which resulted in 14 personal interviews. In addition, 2 interviews were by telephone and in writing. In some instances, individuals were able to discuss the work of other departments, either because they worked closely with them, or alternatively because they had been transferred from that department.

The departments interviewed personally, with details of the interviewees were as follows:

- Department of the Environment, Finance Departmental Service Division. C Khosla. 23.5.90
- Department of Health, Finance Branch. K Gard. 8.8.90
- Department of Trade and Industry, Export Credit Guarantee Department, Finance Division. B Wright. 24.5.90
- Department of Employment, IRA 3. Miss S Guscott. 28.9.90

- Department of Employment, Economic Policy Briefing Section. Miss M East. 16.11.90
- Home Office, Procurement Section. D Diamond. 26.10.90
- Inland Revenue, Compliance and Collection Division, Mrs J Banner
- Ministry of Agriculture, Fisheries and Food, Financial Management Division. C J Lawson. 25.5.90
- Ministry of Defence, Directorate of Procurement Policies. S Clark. 8.6.90
- Ministry of Defence, Accounting, Estimating and Pricing Services. J V A Crawford, 27.6.90
- Office of Fair Trading, Competition Policy Division. M Graham. 4.5.90
- The Treasury, Accountancy Advice Division. D Jamieson. 25.5.90 and K Bradley. 8.6.90
- Department of Trade and Industry, Companies Division. F Jenkins. 19.10.90

In addition, telephone and written information was secured from H M Customs and Excise, VAT Control Division A (A Collard, 15.10.90) and Central Statistical Office, Business Statistics Office (J Knight, 9.8.90). From the remaining departments contacted, one (Ofel), did not reply, and the Serious Fraud Office were not prepared to assist. The remaining departments claimed that the research did not apply to them (although this might be that they were not sure who would deal with such matters).

The officials who were interviewed, tended to be fairly senior within their organisations but often did not have job titles that would be recognisable or comparable with each other. Those whose grades are identifiable from the Civil service Year Book were between grades 4 and 6 (Grade 1 being Permanent Secretary level).

The interviews were largely unstructured and consisted of firstly asking the way in which the department used published accounts. This first question was followed up by enquiries into what further information was

either already secured or needed by the department for decision-making purposes. This then led into the second question which asked whether the department had any input into proposed accounting standards.

Although other points arose during the interviews, which are mentioned at the beginning of Chapter 8, in retrospect, some of these aspects could have been examined in more detail with a view to further research. Additionally, contacts to other potential interviewees in the same department could have been requested at the time (although the Treasury was extremely helpful in suggesting further contacts).

APPENDIX 4

GOVERNMENT DEPARTMENTS AS USERS OF PUBLISHED ACCOUNTS

DEPARTMENT	Relationship Type	Users of Published Accounts	Users of other Information	Basis of Supply		
				By Law	Condition of Rel. Industry Agreement	
Ministry of Defense	Trading	*	*			*
Acc .Est. Pricing		*	*			
E.C.G.D.		*	*		*	
Dept. of Health		*	*			*
Home Office-Proc		*	*			
M.A.F.F.	Grant	*	*		*	
Dept. of Envir.		*	*		*	
Dept. Trade and Ind.		*	*		*	
Office of Fair Trad.	Monitoring	*	*	*		
Monopolies & Merg.		*	*	*		
Employment Dept.		*				
Employee Involmnt.		*				
Ministry of Defense	Overview	*	*			
Procurement Dir.						
Employment Dept		*	*			
Economic Policy.		*				
Dept. Trade and Ind.		*				
Central Stat. Office		*				
Bank of England		*				
Inland Revenue	Taxation	*	*	*		
Customs & Excise		*	*	*		

APPENDIX 5
EXTRACTS FROM GOVERNMENT DEPARTMENTS COMMENT
LETTERS 1980 to 1990

Department of Industry and Trade, Accountancy Services Division, 4th May 1982, Accounting for Leases and Hire Purchase Contracts.

'It would indeed be undesirable if the introduction of an accounting standard adventitiously reduced the willingness or ability of companies to invest in productive assets'

'We would also welcome the proposal in the exposure draft that small companies would at least be permitted to adopt a simplified form of accounting...'

'It may therefore be considered preferable if separate captions were used, with the caption for leased assets making it clear that the asset represented did not constitute ownership rights but rights to the future benefits from use of the assets for the greater part of their useful economic lives'

Department of Trade, 7th April 1983, Accounting for Goodwill

'Departure from this provision is required if following it would not give a true and fair view (1948 Act, Section 149)

'Indeed, paragraph 19 of Schedule 8 to the 1948 Companies Act would seem to require the write-down of shares only if there has been a diminuation in value.'

'Neither of these paragraphs reflect adequately the legal requirement which is stated in Schedule 8, Note 3 to the balance sheet formats.'

'Under section 39(4) of the 1980 Companies Act any provision must be treated as a realised loss and distributable profits would thereby be restricted.'

'It does not adequately reflect the position in law, that the holding company's investment should be stated at purchase price, may only be written down if it is diminished in value and must be written down if the diminuation is permanent (Schedule 8, paragraphs 17-19).'

Department of Trade, 7th April 1983, Acquisitions and Mergers.

'We would suggest that paragraphs 6 and 25 might be expanded to make it clear that acquisition accounting is applied to pre-acquisition profits in respect of shares acquired for non-equity consideration.'

'Neither covers all the disclosure requirements of the 1982 (Accounts and Audit) Regulations...'

Department of Trade, 5th December 1983, Disclosure of Pension Information, ED 32.

'...this adds useful clarification and should be re-instated'

'It would seem useful, if the date of the most recent actuarial valuation is to be disclosed, to have also the date of the next valuation or the frequency of the valuations.'

'...we remain unconvinced that the disclosure recommended would comply with the legal requirements in all circumstances.'

'...it is far from certain that compliance with the proposed standard would ensure compliance with paragraph 50(4) of schedule 8.'

'...but nevertheless feel that it might be useful if ED. 32 were to contain a note on how far compliance with it is compatible with IAS 19.'

' "Small" companies which file modified accounts are not required to file the information required to be given by paragraphs 50 and 56 of Schedule 8. It is not clear what the position of the standard is, in relation to such companies: presumably it is not intended to require them to disclose what the law permits them to withhold.'

Department of Trade and Industry, November 1983, ED 33, Accounting for Deferred Tax.

'We can see no justification for an exemption from the standard for wholly owned subsidiaries, which are subject, as are all companies, to the requirements of Schedule 8 to the Companies Act 1948 as regards deferred tax.'

'We consider discounting of deferred tax liabilities should only be considered, if at all, as part of a proposal in relation to all deferred liabilities and assets.'

Department of Trade and Industry, 8th November 1984, ED 34 Pension Scheme Accounts

'To disclose only the net movement would show the net effect on the funds but to disclose both gross figures would additionally give members an idea of investment activity which at either extreme could be important.'

'We agree that all assets should be accounted for at market value but would suggest that consideration should also be given to drawing attention in the SORP to material change in the market value of assets between the year end and the date of approval by the trustees as required by SSAP 17, Accounting for Post Balance Sheet Events.'

Department of Trade and Industry, 5th July 1985, ED 36 Extraordinary Items and Prior Year Adjustments.

'There is nothing in company law to prevent this but equally there is nothing to prevent the alternative treatment whereby the profit or loss on disposal would be calculated by reference to the carrying amount of the asset in the balance sheet.'

'Paragraph 34 (1) of Schedule 4 provides that these deficits must be debited to revaluation reserve, even if that reserve stands at zero.'

Department of Trade and Industry, 2nd October 1985, ED 37 Accounting for Depreciation.

'We have no problems with the reference to the situation described in paragraph 25 (a), but would like to see an additional reference to the true and fair requirement inserted here.'

Home Office, Voluntary Services Unit, 17th April 1986. Accounting by Charities.

'We should have liked to see a little more guidance in your recommendations on sources and application of funds on the importance of distinguishing (and identifying) public sources of funding.'

Department of Trade and Industry, 29th April 1987, ED 40 Stock and Long Term Contracts.

'However in many cases we would expect that there would be a sufficient element of uncertainty about the amount to make it a provision, as defined by Schedule 4 of the Companies Act 1985 (CA 1985).'

Inland Revenue, Policy Division, 3rd April 1987, ED 40, Stock and Work in Progress

'...we believe that paragraphs 1 to 5 of the statement will need some modification, and I hope to write to the accountancy bodies in more detail...' (Note. This concerns the proposed omission from the new standard of the Board of Inland revenue's statement on the tax treatment of changes in the basis of the valuation of stocks and work in progress.)

Department of Trade and Industry, 19th November 1987, ED 41, Accounting for Research and Development.

'In particular, we support the proposal to require disclosure of R & D charged as an expense in the current year. It should make for greater awareness of R & D and of its importance in assessing company performance.'

'As you know, our view of the law is that paragraph 20 of Schedule 4 to the Companies Act is permissive and would allow companies to follow this policy.'

Department of Trade and Industry, 2nd August 1988, ED 42, Accounting for Special Purpose Transactions.

'We think that the ASC should give further consideration to the need to make it clear in the proposed SSAP where it is simply elaborating on the statutory requirements of the Companies Act 1985, and where the treatment it recommends is based on the use of the true and fair override.'

Department of Trade and Industry, 13th September 1988, ED 43, The Accounting Treatment of Government Grants.

'It contravenes the fundamental accruals accounting concept on which paragraph 27 is based, without the justification of being required by the prudence concept.'

Department of Trade and Industry, November 1988, ED 44, Accounting for Goodwill.

'This proposal, by providing for the disclosure of earnings per share (EPS), before and after the amortisation charge, might reduce the disincentive to amortise and might therefore increase the number of companies which amortise goodwill. Since international accounting opinion is moving in favour of amortisation, this would encourage UK accounting standards and practice to move in line with this trend.'

Department of Trade and Industry, 4th May 1989, ED 45, Segmental Reporting.

'Its implementation into a standard should help to improve the usefulness of company accounts to users.'

'Many users of accounts would prefer to see segmentation by source but we are constrained by the Fourth Directive and disclosure on both bases seems the appropriate response.'

'In particular, we have in mind the inclusion of :-

- treatment of the domestic market as a geographical segment (that is, the UK or, perhaps, the British Isles),*
- disclosure of depreciation taken into account in arriving at segment results*
- disclosure of capital expenditure by segment.'*

'However, there are also other considerations which ought to be taken into account. Government Departments make use of company accounts for statistical purposes. You will no doubt be aware that some of the statistics dealing with the economy produced by the Government has been criticised over the last few years and that action has recently been announced by the Prime Minister to improve their quality. The publication of the ED and the issue of a SSAP in due course could prove to be timely in this context.'

The use of company accounts information in the preparation of United Kingdom national accounts suffers at present because of the absence of adequate segmental data, in particular, a UK segment. Incorporation of sufficient information requirements into the eventual SSAP would therefore be helpful in reducing other reporting demands placed upon companies by Government.'

Cabinet Office, Central Statistical Office, 26th April 1989, ED 45, Segmental Reporting.

'If ED 45 is implemented in a suitable form, it should enable us to cut the number of statistical forms sent to companies by Government and thereby greatly reduce the burden of form-filling on businesses whilst improving the overall efficiency of data compilation and the quality of macro-economic aggregates.'

'We would also like to see the addition of a requirement for geographical segmentation (with the UK as a specified segment) of capital expenditure and depreciation.'

Office of Fair Trading, 2nd May 1989, ED 45 Segmental Reporting

'...we feel that the primary requirement is to meet the information needs of shareholders in assessing performance. Large conglomerate firms, in particular, have the ability to.....conceal the performance of individual sectors from shareholders.'

' We believe that segmental reporting should be aligned, as far as possible, with a company's activities in separate economic markets. In this way, markets will function more efficiently and competition will be encouraged.'

Department of Trade and Industry, 18th September 1989, ED 46, related Party Transactions

'We are concerned that no undue burdens should be placed upon companies and think that the application of the proposed standard to small companies could impose a reporting burden which is not fully justified....Therefore disclosure...by large companies is more justifiable than in respect of small companies when such information may be commercially damaging.'

'As a result of the support expressed by the UK for the objective of the IASC, any non-compliance by the UK with IASC standards is likely to be given a higher profile than hitherto.'

Department of Trade and Industry, 31st July 1990, ED 48, Accounting for Acquisitions and Mergers.

'...we think it would be preferable for the standard to use the same term as the Act.'

'...we think it would be useful if the section dealing with the legal requirements in Great Britain were to be expanded to describe the requirements of paragraphs 9,11 and 12 of the new Schedule 4A to the Companies Act 1985.'

APPENDIX 6

EASTON'S MODELS OF POLITICAL SYSTEMS

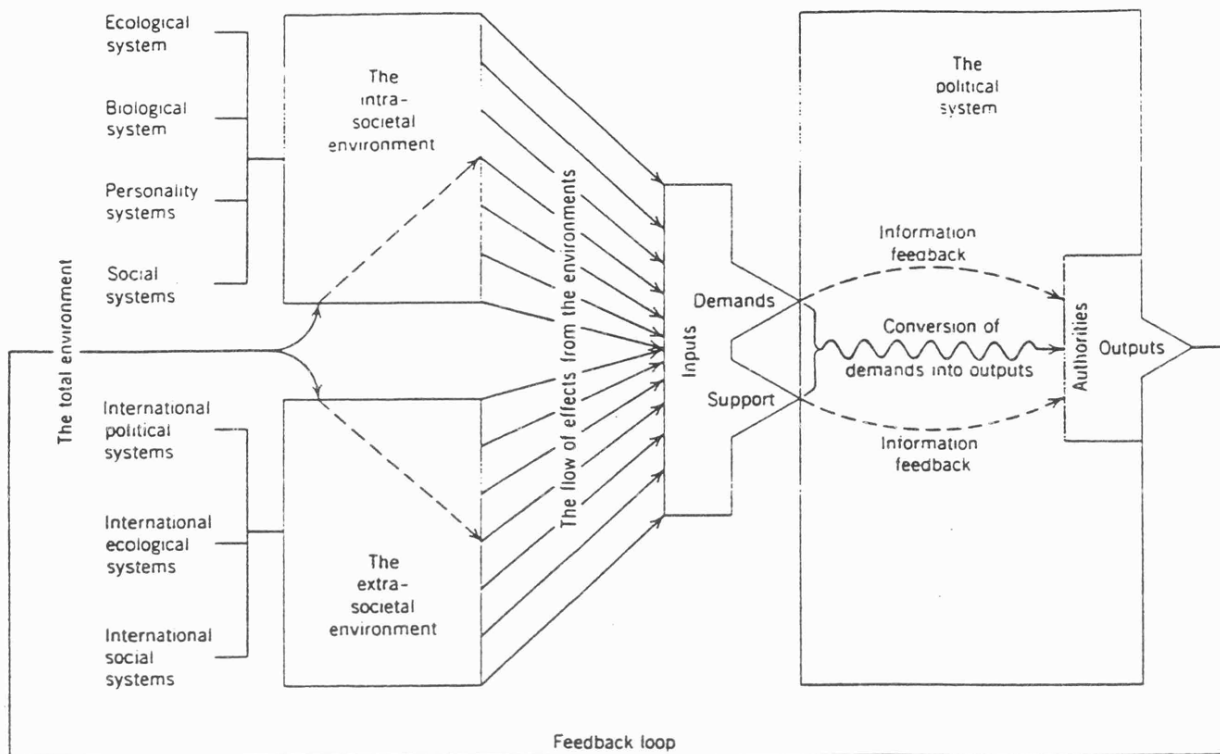


DIAGRAM 1 A DYNAMIC RESPONSE MODEL OF A POLITICAL SYSTEM

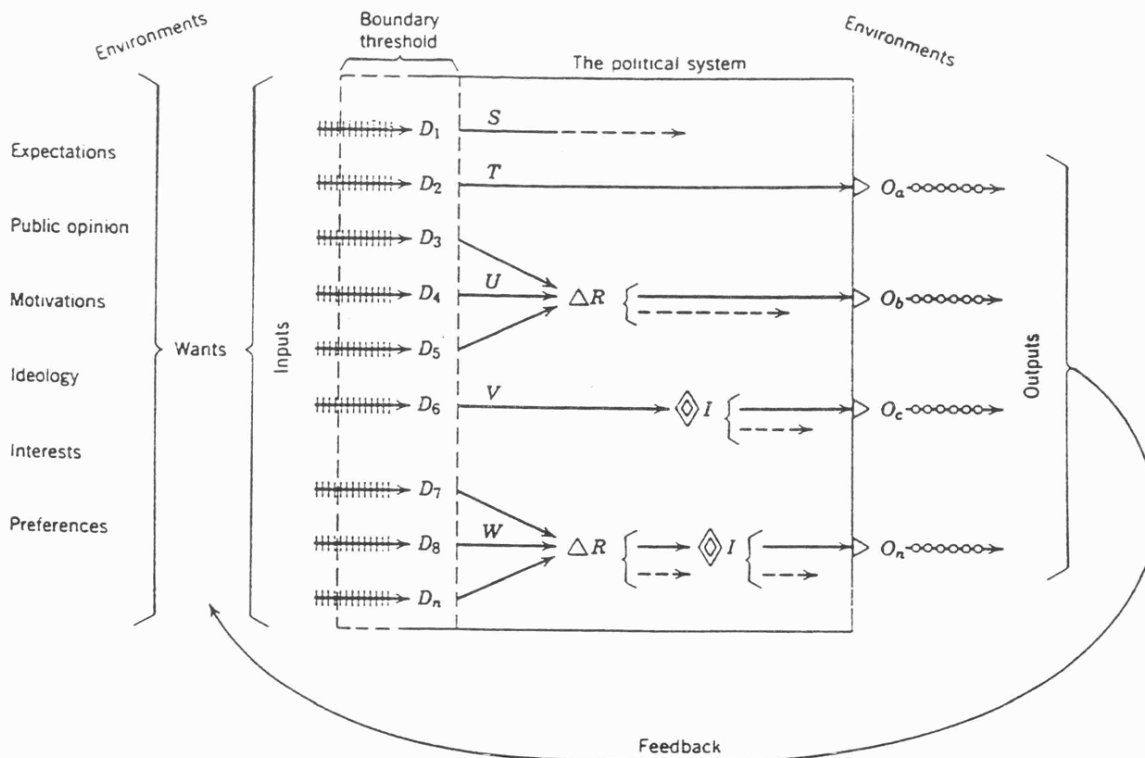


DIAGRAM 3 TYPES OF DEMAND FLOW PATTERNS

APPENDIX 7
LETTERS FROM J WINTERS

23, D'URBERVILLE DRIVE, SWANAGE, DORSET. BH19 1QN.
Swanage (01929) 424126 (Answerphone)
16 January 1997

Dear Robert,

As requested, I have looked for the correspondence that you require.

Naturally, the original is with Skerratt and my contemporary copy was thrown away when I left the ACCA's Research Committee.

However, thanks to the wonders of word processors, I still have the text on disk and I enclose a copy - complete with my permission to reproduce/publish it.

Unfortunately, I do not have a copy of Skerratt's reply, but it said, in general terms, that the requirement (or it might have been "advice") was to preserve the papers in the format in which they had been retained by the ICAEW. The fact that no committee member or committee secretary would have dreamed of using that format for their own purposes was thus ignored.

I do hope that this is what you want; but if not, please do not hesitate to get in touch again.

Yours,

Jerry

23, D'URBERVILLE DRIVE, SWANAGE, DORSET. BH19 1QN.
Swanage (0929) 424126
18 January 1994

Dear Professor Skerratt,

In July 1993, you kindly arranged for me to have access to the archive of ASC papers held in the John Rylands University Library. In September I attended the Library and was received with exemplary kindness and consideration by the staff.

Unfortunately, I have come to the reluctant conclusion that I will be unable to write the book (or collection of papers) dealing with the early years and early products of the ASC which I had intended.

In the covering booklet to the catalogue, indication is given of the unsatisfactory nature of the English Institute's policies relating to the collection and storage of important material. As former Deputy Technical Director and, inter alia, Secretary of the Accounting Standards Committee, I can confirm that these policies were frequently applied without benefit of a sense of proportion by the Institute's then archivist and often followed with grudging reluctance by hard pressed staff. The policy was based on the view that an Agenda recited "Things to be done" and that the resulting minutes described the decisions taken in respect thereof. Supporting papers were of no account.

As a researcher, I found that this rendered the papers, in their existing presentation, unusable. The disk catalogue itself reveals a confused collection of unconnected oddments.

In particular, the Institute's early policy (not followed through in all of the later years) of detaching the attachments from the related agendas and only filing the latter, makes reconstructing the flow of the ASC's affairs impossible. Furthermore, the lack of any sequential record by topic, renders that approach to research also unavailable.

May I suggest that, if funds can ever be found, a new approach to this unique archive should be explored. What, I suggest, is needed, is that the files should be dismembered and completely reconstructed. The mess created by the Institute is not, of itself, worthy of retention; the material contained therein is what matters.

One set of files should be built up on the basis of time. This set would have as its starting point the minutes of each ASSC or ASC meeting. These should be reconstructed by adding, wherever possible, the related topic texts, many of which exist in different files on a rather random basis.

The second set would be by topic and would, again, be reconstructed on a calendar basis. Naturally, some of this material would be a duplicate of material in the above ASSC/ASC files, but this would be a valuable duplication enabling either aspect to be considered in its own right.

To each of these sets of files would be appended a subset dealing with the routine correspondence appropriate thereto. To the topic based files would be appended a further subset dealing with comments received on exposure, to the extent that these are available.

Once the above had been completed, it might be possible for the person undertaking the work to fill in some of the gaps by appealing to the firms whose partners served on the ASC and on its subcommittees to examine their own archives for stored material.

Considerable expense would be involved. The archivist's costs, transport and storage of the files and office accommodation (on the assumption that the worker was not prepared to take up residence in Manchester for the one or two years the work would take) and extensive photocopying to complete the two sets of papers.

Unfortunately, the work needs to be done by someone with some knowledge of the technical side of the ASC's work and also of the way in which it operated. However, the end product would, I suggest, be a valuable and valued source of material truly worthy of study.

I trust that the above thoughts will be of some interest. I would, of course, be happy to discuss the ideas merely outlined above should you wish.

Yours sincerely,

Jerry Winters