

## A Critical Review of Accounting Standard Setting

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### A Critical Review of Accounting Standard Setting and the Role of Government from 1980 to 1990

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#### Summary

In the UK, the role of the state in accounting regulation has been ambivalent for some decades. On the one hand, confidence has been openly expressed in the system of private sector accounting regulation<sup>1</sup> while accounting standards have been granted legitimacy through recognition in company law<sup>2</sup>. On the other hand government has introduced some detailed regulation through company law and has always been involved in both the institutions and processes of private sector regulation. This involvement has not necessarily been passive, and has often been covert leading to reports of threats of counter-action by the government on some specific issues (Robson, 1988). Indeed, it is felt that fear of intervention by the government provides some of the rationale for private sector regulation (Bromwich, 1981, Sharp, 1971, Taylor and Turley, 1986). Providing a sharp contrast to the UK government's actions towards the standard setting body, the sunshine policy of the Financial Accounting Standards Board (FASB) in the US, means that governmental influence is overt whether in the area of a single issue or the future of the private sector standard setting (Beresford, 1993).

The role that government in the UK plays in the development of accounting standards by the private sector, is defined by the arenas

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<sup>1</sup> See for example Hansard Vol.182 and Vol.183.

<sup>2</sup> Companies Act 1989

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in which the state is involved with published accounting reports. The study contained in this paper identifies three roles that the state assumes in respect of such reports. The state may be a preparer of similar information, it may be a user of information and it may see regulation as falling within its function of governing. There may however be some overlap in that actions taken while assuming one role may be influenced by considerations of other roles.

Those 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 accounting functions, must presume some degree of commonality in operations. The presence of professionally trained accountants in departments and agencies ensures a degree of diffusion of ideas. Furthermore, the government by moving away from traditional cash-based accounting makes this diffusion of practice more significant.

The second role of government 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)

The appendix to this paper 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

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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<sup>3</sup>. Nevertheless, since 1970 its responsibilities have been 'shared' with a private sector regulatory body. While more prescriptive rules have grown within company law, a formal body of accounting standards developed by the private sector, but with semi-legal backing have appeared. Any state interest in these standards could be influenced by its perception of best practice in respect of its preparer role, by its needs as a user or through the realisation that economic consequences may affect policy objectives.

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<sup>3</sup> See for example Edey and Panitpakdi, 1956

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### Approach of this study

In order to understand part of the complex relationship existing between the state and the private sector, a study was made of the reasons for state interest in published accounting information and the way in which interaction with the regulatory process takes place. Interviews were held with representatives of several governmental departments and agencies which were identified as using published accounting information<sup>4</sup>. 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 entities which identified the government's information needs. These relationships are specified in a later section of this paper. 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 government departments, but rather represent substantive examples, in order to provide an illustration 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

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<sup>4</sup> The research was carried out in 1990 and reflected the structure, functions and operating environment of government and agencies at around that time.

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have not been taken further in this paper, as the process of adoption of those practices seen as desirable by the state is beyond the scope of this work<sup>5</sup>. The role played by the Department of Trade and Industry<sup>6</sup> (DTI, formerly Department of Trade, DoT) in accounting rule-making ensured that there was 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 determination of the role of government can also be illustrated by drawing on two other instances of interaction between the government and the accounting standard setters. Firstly there are the comment letters written by specific departments in response to Exposure Drafts. These letters represent the overt views of government towards an issue, and their content could provide evidence of possible motives for the government's involvement in private sector accounting standard setting. Government Departments, especially the DTI, 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 policy objectives or acting in what they consider to be the public interest (which are not necessarily mutually exclusive goals).

Additionally, since the archives of the Accounting Standards Committee (ASC) have been made available for research, it has

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<sup>5</sup> Generally the interviewees indicated that the government adopted those practices and methods it saw as applicable, while rejecting those it saw as inapplicable or undesirable.

<sup>6</sup> As an observer on both the ASC and ASB.

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been possible to examine further interaction by the DTI with the ASC, although many papers have been removed as being confidential<sup>7</sup>. The two topics specifically addressed in the context of this research, relate to the development of the goodwill and foreign exchange standards during the 1980's, which represent two substantive examples of government interaction with the accounting standard setting body.

### **The user role of Government**

From the results of these interviews, many government departments and agencies are confirmed as users of published accounting information. Within a department, different sections may have different requirements based on their individual roles and responsibilities. The information requirements of these departments or sections depend upon the relationship between the reporting entity and the government department. The study identified five distinct relationships as follows:

- 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 investigating and subsequently monitoring actions e.g. Monopolies and Mergers Commission.
- Where departments are not necessarily interested in specifics, accounting data may be used to gain an

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<sup>7</sup> 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 always possible to ascertain their subject matter.

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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 such 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. Where a general overview is required there are usually no additional powers to secure information<sup>8</sup>.

Table 1 illustrates the types of relationship mentioned above and links these to government departments. It also specifies which

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<sup>8</sup> Appendix 3 summarises the interviews with departments and provides detailed examples.

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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 by nature of 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 was one of the few Departments apart from the DTI, making its own comments to the ASC.

If therefore the majority of Departments is 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 attempting to secure decision-useful or performance monitoring information on behalf of those Departments by demanding better disclosure or alternative measurement approaches. Their own perception of their role is detailed later in this paper and compared with their 'public face' in making replies to Exposure Drafts as well as their involvement in the regulatory process, as evidenced by the ASC archives.

### **Government replies to Exposure Drafts**

Replies to Exposure Drafts made by government Departments and Agencies from 1980 to 1990 were analysed for the purpose of this research. The starting point was 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 marked the year before the EC 4<sup>th</sup>



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Directive was incorporated into UK law through the Companies Act of 1981. Thus any effects of anticipating provisions of the Act may have been incorporated into both the Exposure Drafts and the replies. The final year marked the end of the ASC and the formation of the ASB (Accounting Standards Board)<sup>9</sup>.

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, Foreign Exchange, ED 39, Pension Costs and ED 47, Goodwill). With the exception of these, the Department of Trade and Industry have commented on all but one (ED 38, Charities) which was commented on by the Home Office. Other Departments involved in submitting comment letters are the Inland Revenue (ED 40, Stocks and Long Term Contracts) and the Office of Fair Trading and the Central Statistical Office (both ED 45, Segmental Reporting). Although the latter office was 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 2.

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 were under discussion, or possibly where the views of the department were different from the DTI.

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<sup>9</sup> And the end of the availability of archival material from the standard setting body, as only the ASC allowed access to its files.

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An analysis of the content of comment letters submitted by government departments, suggests five main contexts in which the replies were made:

- economic policy
- technical matters
- compliance with law
- compliance with international standards
- additional disclosure

Where a reply related to any of these areas, the substance of such a reply was 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 covered by the latter.

Some Exposure Drafts appear to have drawn comments directly referring to areas of economic policy<sup>10</sup>. 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

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<sup>10</sup> Economic consequences literature 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.

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will be encouraged' (OFT 2.5.89). There was an emphasis on exempting small companies from compliance on four separate occasions, EDs 29, 32, 45 and 46. This presumably was in accordance with government policy concerning the encouragement of small businesses<sup>11</sup>. However, on nine occasions, the appeal by the government was 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 disclosure<sup>12</sup>.

The majority of replies included comments of a technical nature (classified as 'Clarification of Detail'). 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 tended to be in the realms of the technical, this specific categorisation covers such areas as 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) was an area where the DTI appeared to be extremely active (commenting on 11 occasions), even though

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<sup>11</sup> See for example the Conservative Party Manifestos of 1979 and 1983.

<sup>12</sup> Stocks and Harrell (1995) equate increase in the level of accounting information with better decisions, (although they concluded that groups benefit more than individuals).

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when interviewed they claimed this as being a fairly minor role in their examination of exposure drafts. However, major conflicts between standards and the law in the past e.g. SSAP 4 (Accounting for Government Grants) and SSAP 9 (Accounting for Stocks and Work-in-progress) have led to revisions to the standards.

Compliance with International Standards were mentioned on three occasions (ED's 32, 43 and 45). It may appear somewhat paradoxical that the government was reminding the standard setters (who were 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.

Table 2 summarises the areas into which government's replies to Exposure Drafts fall.

### **The Accounting Standards Role of the DTI**

The Department of Trade and Industry was one of two Government Departments with representation on the ASC<sup>13</sup> (the Companies Division of the Department had observer status). Within the process of standard setting, the Division saw its role as two-fold<sup>14</sup>. The first of these was to communicate and sound out the views of other departments. This was carried out by way of forwarding exposure drafts to most departments for comments

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<sup>13</sup> And subsequently on the ASB

<sup>14</sup> Source - interview with the DTI on 19.10.90.

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Although departments were invited to reply, the process appeared in practice to be one of communicating information rather than securing replies. In addition the DTI looked at all replies to Exposure Drafts (subject to time) and could have sought advice from other departments or the Bank of England on specialist matters.

The Department's second role in standard setting was concerned with compliance with the law, but the perception of the DTI is that this was a minor role. They ensured by their involvement in the process that standards complied with the Companies Act. At times, they were represented and operated within any working group of the standard-setting body involved with legal matters. The Companies Division claimed, however, that it devoted 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, a representative 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 did seem to occur in that their acceptance of elements of the standard seemed to be important to the ASC. It is recorded in the minutes of a meeting on 21.1.83, that:

"The ASC representatives explained how they had dealt with the individual comments made by the

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DOT<sup>15</sup> 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 did appear to have been accepted some three years earlier in a letter from Jenkins (DOT) to Carty (ASC secretary) dated 7.5.80:

'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 showed 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 exists. In a letter dated 10.9.79 from Knox to Wild (of the ASC) he stated;

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<sup>15</sup> Department of Trade, now DTI.



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' ... 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 (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 Department of Trade comment letter on ED 30 which was publicly available starts with the words 'Since we in this Department were closely involved in the formulation of ED 30, Accounting for Goodwill, you are probably not expecting us to comment much further.' (letter to ASC dated 7<sup>th</sup> April 1983)

The extent of government 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

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accounting regulation<sup>16</sup>, but also were pro-active on occasions as John Redwood (Secretary of State for Trade and Industry) stated in 1991;

'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, as already noted, the DTI had stated that they considered their role in regard to accounting standards was one of communication of information to other departments and receiving their comments whilst ensuring compliance with company law was a secondary role. The incidences of other departments responding to exposure drafts was 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 have taken 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 was only the DTI themselves who were concerned with accounting standards although during an interview with the writer they tended to marginalise their involvement. This 'official' attitude is perhaps illustrated by 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 it the Department's role to say whether a standard should or should

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<sup>16</sup> 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).

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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 at least on one occasion they voted on a draft standard<sup>17</sup>. (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 overall 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 memo from Rawlins to Davison prior to the latter's Chairmanship of the ASC, excess government interference from their representatives was mentioned (ASC 5/3/5, dated 25.5.82).

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<sup>17</sup> 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 this implies that ASC were concerned about official opinion. In any case it does elevate the position of 'observer' and give government a higher status than other groups (Interview with J Winters, 1995).

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### Conclusion

The motivation for state involvement in standard setting would appear to exclude its 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 this paper has identified that their needs appeared to be satisfied either by the then existing reporting practices or through their powers both formal and informal to secure additional information.

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 more efficient decision-making. Clarification of technical matters might also assist with this. The interest of the state in accounting would not appear to be the passive role of allowing reports to influence their own 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 taking place outside the normal policy-making arena unless they can exert a degree of influence because of the presence

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of the economic consequences of such regulations<sup>18</sup>. The emphasis on ensuring that standards comply with UK law is one area in which the state is attempting to exercise an overall control. During the period of this study the main enforceable authority for accounting would appear to be derived from company law<sup>19</sup>. It was not until later that disclosure of compliance with accounting standards became mandatory, thus introducing a further source of quasi legal regulation. However in the period in question, the lack of detailed accounting rules promulgated by the state would appear to indicate the acceptance of a framework under which the accounting profession made 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 power to institutionalise the process of standard-setting totally<sup>20</sup>, 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)

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<sup>18</sup> See for example Bromwich 1981, Taylor and Turley 1986

<sup>19</sup> Renshall (1992), states that to his knowledge no member of the accounting bodies was ever disciplined for non-compliance with accounting standards.

<sup>20</sup> The idea of such intervention although unprecedented has been used as a direct threat in the US (Beresford 1993).

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The government however, may have felt that it did not need to pressurise the ASC . The fear of intervention felt both in 1970 at the time of its introduction and again in 1990 with the setting up of the ASB was widespread in the accounting profession. Although put forward as a purely hypothetical scenario, Luehfling (1995), describes a situation where an accounting crisis provokes a public outcry leading to demands for government action. The response of government is to promise such action. Meanwhile, the private sector responds in order to pacify both the public and government who are then provided with an alternative to legislation. The accounting establishment is then placed on probation with the government assuring the public that it will monitor the situation. In the case of the ASC, it may be that the monitoring function was taken further. It is difficult to imagine that the ASC was not conscious of being 'on probation' especially whenever there existed government opposition to a draft standard during the period in question.

However, incidences of state pressure do not appear within the replies to exposure drafts which tend to state a view rather than threaten action. The real pressure may be perceived by the accounting profession determined to maintain the setting of accounting standards in the private sector, yet who operate in an environment in which accounting standards and the law are inevitably entwined. There exists evidence that at least on one occasion (in the face of non-compliance with SSAP 16) that the ASC considered asking the DTI for legal backing for the standard (ASC 1/81/1). Despite the close relationship between the ASC and the government, the denial of the DTI in the interview quoted in this paper of their role in setting standards does not accord with the evidence of the time and resources they expended in attending meetings and becoming members of various sub-committees.

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The very nature of accounting rules and the economic consequences they introduce implies that accounting standard setters are only able to operate within certain bounds. However there are advantages to government, which accrue from using non-governmental agencies such as the ASC. Baldwin and McCrudden (1987) discuss certain motives for agency use among which are:

- giving the appearance that the government is doing something
- avoiding political dangers of policy administration
- avoidance of awkward or burdensome duties being added to departments
- the use of better administration, specialisation and expertise

Certainly the accounting problems leading to the setting up of both the ASC and ASB were recognised in Parliament with both bodies being quoted as the solution to the problem. The avoidance of political dangers is recognised by Lewis's (1985) escape theory under which agencies produce desirable results (from the governments' point of view) without the government having to take unpopular actions. The final two points of Baldwin and McCrudden are linked in that it might have been extremely convenient for the DOT/DTI to use the ASC in that according to Gower (1984), in that year, the Companies Legislation Division of the DTI had no lawyer or accountant, and only four staff who had been in post since 1980.

The relationship between the standard setters and the government in the 1980's would appear to represent a system whereby both parties benefitted to a degree. The government secured both economic and political efficiency from the arrangement whilst the accounting profession managed to retain control of the regulatory process. However, the presence of economic consequences of regulation meant that the ASC did not have delegated authority, although they appear to been allowed to operate within limits.

**APPENDIX 1  
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;



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- (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 2**  
**REPLIES TO EXPOSURE DRAFT**  
**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 diminution in value.'*

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*'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 diminution 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.'*

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*...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*

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*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*

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*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.'*

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### **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.'*

*'The government in setting the terms and conditions of a grant, and a company in deciding whether to accept a grant, will usually take account of the standard. The exception in paragraph 32 is more likely to complicate than help these decisions. We note that IAS 20 does not have a similarly worded exception.'*

### **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),*

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- *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.'*



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### **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*

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*requirements of paragraphs 9,11 and 12 of the new Schedule 4A to the Companies Act 1985.'*

***APPENDIX 3***

**INTERVIEWS WITH DEPARTMENTS AND AGENCIES**

**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 inflation<sup>21</sup>. 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 difficulties<sup>22</sup>. 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

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<sup>21</sup> This work was continued by the DTI itself.

<sup>22</sup> This function had developed since the oil crisis of the 1970's.

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appointment of the directors of the Financial Reporting Council (FRC).

### **The Central Statistical Office**

Since the 1940's, the Central Statistical Office<sup>23</sup> 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

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<sup>23</sup> Now named Office for National Statistics.

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Business Monitor (MA3) produced formally by the Department of Trade and Industry<sup>24</sup>.

### **Department Of The Environment (Housing)**

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 in the relationship between equity and debt. The practice of securitisation of mortgages caused problems in that these 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 lenders<sup>25</sup>.

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

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<sup>24</sup> Information is now obtained from alternative sources.

<sup>25</sup> FRS 5 has effectively overcome this problem by limiting the situations in which securitised mortgages can be de-recognised.

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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.

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 allowed

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on assets, 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

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funds together with various accounting ratios<sup>26</sup>. 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 accounts 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.

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<sup>26</sup> At the time of the original research, SSAP 10 was extant.



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### **Export Credit Guarantee Department<sup>27</sup>**

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

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<sup>27</sup> A non-ministerial government department.

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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 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.

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### **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. These are then subject to ratio analysis to ensure their suitability. If the 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.

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### **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

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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. Now, 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 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 EC (European Community) 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

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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 paper.

### **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

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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 Commission<sup>28</sup>. 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.

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<sup>28</sup> For an example, see the GEC/Siemens proposed take-over of Plessey (Cm 676, April 1989).

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### **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 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.

The Ministry has not made any direct submissions to the Accounting Standards Committee in the period under examination.



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### **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 claims to make its' own submissions to the ASC and comments were submitted on ED 45 (Segmental Accounting) which they supported as super-normal profits would be highlighted and thus new entrants attracted 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

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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 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 directly 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 account<sup>29</sup>.

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<sup>29</sup> Although Customs and Excise did admit that detailed profit and loss accounts submitted by smaller enterprises were of greater assistance.

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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 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.

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