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A Possibilitarian History of Price Change Accounting in the UK: 1971–1985

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ABSTRACT *This paper offers a 'possibilitarian' analysis of the history of price change accounting in the UK, exploring how events might have turned out differently at a number of key nodal points. It argues that a stable current cost accounting regime could have been established significantly before SSAP16 was in fact adopted or, alternately, that the retreat from SSAP16 could have been managed in a way that would have maintained compliance with current cost accounting. Had a substantial period of widespread compliance within a stable regime eventuated, a quite different dynamic might have emerged, including significant user pressure to maintain current cost accounting, thereby underpinning the regime and leading to its long-term survival.*

KEY WORDS: Accounting Standards Committee; alternative history; counterfactuals; current cost accounting

Introduction

In January 1973, the recently established Accounting Standards Steering Committee (ASSC) published an exposure draft, ED8, proposing a form of price change accounting known as Current Purchasing Power (CPP). CPP corrects for the impact of general price changes on the unit of measurement but does not reflect changes in the prices of goods and services used or produced by any particular entity, except to the extent that these move in line with the general price level. Six months later, the government announced that it was establishing an official enquiry into price change accounting. The Sandilands committee reported in June 1975, recommending a form of Current Cost Accounting (CCA), to be implemented by an accounting standard. CCA reflects changes in specific prices but does not correct for the impact of general price changes.

Development of a standard from Sandilands proved extremely difficult. Two drafts had to be exposed by the Accounting Standards Committee (ASC), as the ASSC was now called, in November 1976 (ED18) and April 1979 (ED24). Interim recommendations (the Hyde guidelines) were issued in November 1977. The standard, SSAP16, was adopted in March 1980, nearly five years after the Sandilands report was completed.

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SSAP16 had a short life, its mandatory status being suspended in June 1985. Two further exposure drafts were prepared: one was published, in July 1984 (ED35); the other remained unissued because it did not command sufficient support. In December 1985, the ASC announced that it was effectively giving up the attempt to establish a standard on price change accounting.[1] The abandonment of CCA was a very significant event in the life of the ASC: it is regarded by some commentators as heavily implicated in the major structural changes in standard setting that took place a few years later (see, for example, PricewaterhouseCoopers, 2005: paragraph 2.17).

The failure of 'the current cost revolution' (Tweedie & Whittington, 1997: p. 149) is usually attributed to a combination of falling inflation and the government's unwillingness to adopt the system for corporation tax purposes,[2] but was it really an inevitable consequence of these two factors? This paper employs the methods of alternative or counterfactual history to examine that question. Counterfactual methods have long been used in mainstream history; Ferguson (1998b) identifies passages of counterfactual speculation in Gibbon's *The Decline and Fall of the Roman Empire* and dates the first book-length counterfactual study to 1876. Recent work has increased the methodological sophistication of the approach (Jordanova, 2000: p. 111).[3] Although counterfactual methods draw on the imagination, it is possible to distinguish alternative history from counterfactually inspired creative writing: the alternatives contemplated in the former are always derived from an analytical method and rooted in the historical record.

There have been very few counterfactual accounting histories, although price change accounting has featured in two of them. Clarke (1980) discusses the role of accidents in the development of price change accounting *ideas* in the 1920s and 1930s. Burrows & Rowles (1997) rely on Australian experience to argue that interest in price change accounting in the UK would have waned even without the progressive decline in inflation but this speculation, unlike the present paper, takes the state of affairs prior to the decline as given.

The remainder of the paper is structured as follows. First, counterfactual methodology is examined. The following section analyses four 'nodal points' – that is, points in the course of price change accounting history at which events might have turned out differently than they did. The four points are: (a) the ICAEW Council's response to a letter from Sir Henry Benson to the President in March 1971; (b) the design of a system responding to the Sandilands report; (c) the reaction to the defeat of ED18; and (d) action by the ASC in autumn 1982. Each node is addressed separately, so that what emerges are possible alternative outcomes at various times rather than a single coherent alternative narrative – it is for this reason that the title of the paper refers to a 'possibilitarian' history. Within the analysis of each node, sub-sections distinguish between observations on history as it actually happened and speculation about history as it might have happened. To underline the distinction between alternative history and counterfactual fiction, some examples of the kinds of speculation that cannot appropriately be entertained in alternative history are examined briefly for some of the nodes.[4] The following section asks whether an alternative outcome at one of these nodes would have made a difference in the long term and a concluding section summarises the arguments.

The Methodology of Counterfactual History

The analytical purpose of counterfactual speculation in history is to assist in the identification of cause and effect (Carson & Carson, 1998; Llewleyn, 2003: p. 697) and its methods reflect this purpose. In historiography, a counterfactual is 'an argument of the form "if event X had not happened or had taken a different form, then the actual known course of events Y would have been significantly different"' (Davies, 2003: pp. 131–132). Since it is not possible to perform repetitive experimentation in historical investigation, counterfactuals are inevitably 'speculative claims' (Jordanova, 2000: p. 212), generated creatively by a 'bold exercise of the mind' (Bloch, 1992: p. 103). The methodology of counterfactual history is concerned principally with the constraints on the historian's powers of imagination to be applied if the result is to qualify as historical investigation. Two classes of constraint can be identified, the analytical and the empirical.

Gaddis' re-working of Bloch's model of causal explanation in history (Gaddis, 2002: pp. 93–102) identifies the role of counterfactuals. All events have a multitude of antecedents which contribute to the event in that, without them, it would not have occurred; Bloch used the example of a person falling off a cliff, an event which would not have occurred without their foot slipping, but equally would not have occurred without the path having been constructed along the cliff edge, the geological formation of the cliff in the first place, and the laws of gravity working as they do. In analysing causation, greater importance is attached to the more proximate antecedents of the event. In judging the relevance of causes neither so immediate as to be directly implicated in the event nor so distant as to be irrelevant, a distinction is drawn between *exceptional* and *general* causes:

> The placement of the path, the existence of the mountain, the effects of gravity were all general causes of the accident: they were *necessary* for the death to have occurred, but they weren't in themselves *sufficient* to explain it.
>
> (Gaddis, 2002: p. 97)

The historian focuses principally on exceptional causes. However, these depend for their effect upon general causes (slips on cliff edges are more dangerous than those in meadows, for example), so that it is important to understand exceptional causes in their context.

To distinguish between general and exceptional causes, Gaddis draws on the work of Roberts (1996), whose approach Gaddis regards as analogous to the paleontological model of 'punctuated equilibrium' (Gaddis, 2002: pp. 98–100). Historians test for exceptional causation by 'seeking a "point of no return": the moment at which an equilibrium that once existed ceased to do so as a result of whatever it is we're trying to explain' (Gaddis, 2002: p. 99). The test of whether what it is we are trying to explain resulted in the disturbance is to construct a counterfactual speculation as to what would have occurred without it: 'historians transport themselves "to the time before the event itself, in order to gauge its chances, as they appeared upon the eve of its realisation"' (Gaddis, 2002: p. 100, quoting Bloch, 1992: p. 103).

As Ferguson (1998b: p. 83) points out, the number of possible counterfactual speculations at any particular node is effectively unlimited. Berlin (1960) was the first to emphasise the significance of plausibility in selecting worthwhile counterfactual speculations. Ferguson explains that plausibility is related to probability but that 'historical probability is more complicated than mathematical probability' (1998b: p. 86; see also Parker, 1997: p. 137) because past events can influence current choices. How are historians to operationalise the distinction between plausible and implausible speculations? Ferguson proposes a protocol which is, itself, historically grounded:

> We should consider as plausible or probable *only those alternatives which we can show on the basis of contemporary evidence that contemporaries actually considered* . . . Moreover, we can only legitimately consider those hypothetical scenarios which

> contemporaries not only considered, but also committed to paper (or some other form of record) which has survived–and which has been identified as a valid source by historians.
>
> (1998b: pp. 86–87, emphasis in original)

Strict application of Ferguson's criteria would be highly demanding: contemporaries may not have contemplated all possibilities that would have seemed plausible, and the requirement that the speculation survives 'introduces an additional element of contingency' (Ferguson, 1998b: p. 87). Ferguson himself hints at the possibility of some relaxation:

> We must attach . . . importance to all the possibilities which contemporaries contemplated before the fact, and *greater* importance to these than to an outcome which they did not anticipate.
>
> (1998b: p. 87, emphasis added)

It is also important to appreciate the *kinds* of speculation that Ferguson is prepared to admit. His own methodological essay introduces a collection of alternative histories (1998a) which he considers satisfy his 'key methodological constraint' (1998b: p. 87), as described here. It is illuminating to reflect on the range of evidence adduced for the counterfactuals involved. This includes:

(a) The opinions of several of his own supporters, to justify the speculation that Charles I might have won the war of 1639, and without the need of a Parliament to authorise the funds (Adamson, 1998).
(b) The possibility that it would have come about had Hitler followed the documented advice of his generals, to support the speculation of Nazi victory over the Soviet Union (Roberts, 1998).
(c) A speech he was due to make on the day he was assassinated, to support the speculation that, contrary to what is often suggested, had John F. Kennedy lived, he would have continued the USA's involvement in Vietnam (Kunz, 1998).

Yet supporters tell leaders they will succeed, generals are bound to claim their advice will lead to victory, and politicians reaffirm policies until the moment they change them. This point is not made to challenge the validity of the speculations; what is important is that Ferguson does not claim that the necessary contemporary speculation should be authoritative, explicit, widely-supported or disinterested; it is enough that it can be teased from the historical record.

Alternative Histories of Price Change Accounting in the UK

Node 1: The Response to Sir Henry Benson's Letter of March 1971

History as it happened

When the ASSC was established in 1970, it adopted an initial five-year work programme including a topic on 'accounting for changes in the purchasing power of money' (Institute of Chartered Accountants in England and Wales, 1970). At this stage work on 12 of the 20 topics on the programme was already under way within the ICAEW, having been taken over from the previous machinery for developing technical pronouncements. No work had been done on price change accounting and, no doubt partly for this reason, an exposure draft was not scheduled until the end of the five-year period. It is not possible to trace a moment at which the decision to adopt CPP for the project was taken, although it seems to have emerged within the ICAEW secretariat before the drafting committee began work.[5] Indeed, it is possible to discern the lineaments of the decision in the title of the topic given in the initial work programme.[6] By April 1971, the topic was with a drafting committee (Institute of Chartered Accountants in England and Wales, 1971c) and preliminary discussions were focussing on CPP (Institute of Chartered Accountants in England and Wales, 1971e), although no draft had been prepared.[7]

It is unsurprising that CPP was attracting substantial support, given the context within which work was being undertaken. In 1966, Gynther observed that general price index methods were tending to attract those concerned with external financial reporting, because they focus on maintaining proprietorial capital in real terms (44–46), while systems based on specific prices were favoured by those who believed that 'the whole or prime purpose of accounting is to assist the entity . . . in its daily struggles' (45). CPP is also a less radical shift from historical cost and has further attractions for auditors (Tweedie & Whittington, 1984: pp. 70–72). Its use of data from an external source (generally, official statistics), makes it objective so far as individual entities are concerned and thus straightforward to audit. It is also economical to set up, operate and audit: if an accountancy profession dominated by auditors was to be seen as imposing a major change in financial reporting, at least it would not be causing heavy costs.

However, the technical virtues of CPP, even in relation to the limited objective of maintaining proprietorial capital, are not overwhelming: for example, the general indexation of net assets demonstrates capital maintenance in real terms only if carrying amounts are scrupulously tested for recoverability, thereby introducing significant judgement, and therefore cost and audit difficulty, into the procedure. Further, the drafting committee was far from being restricted to auditors: almost half its members had a background in industry.[8]

An important factor in influencing the level of support for CPP in the UK was the 1968 ICAEW publication, *Accounting for Stewardship in a Period of Inflation*, setting out the case for the system. Although it was published in the name of the Institute's Research Committee, the driving force behind the report was the President of the ICAEW at the time, W.E. (later Sir Edmund) Parker (Morpeth, 1981: p. 43) and this became widely known. In the words of Michael Renshall, the ICAEW's Technical Director during the development of ED8:

> Parker was seen as the most academic and intellectual of his generation of presidents, and highly respected for it within the profession – by practitioners, if not those in finance, industry and commerce . . . Parker's work rapidly assumed the status of holy writ.[9]

As the drafting committee deliberated, inflation accelerated (Westwick, 1980). The immediate trigger for an increase in the urgency with which the profession was acting, however, was a letter written in March 1971 by Sir Henry (later Lord) Benson, a former President of the ICAEW, to the current President, Claude Croxton-Smith. In his letter, Benson suggested that 'the Institute should take the lead in the urgent consideration of the question of financial administration and accounting under inflationary conditions' (Westwick, 1980: p. 356). The Council of the ICAEW dealt with Benson's letter by referring the matter to the

ASSC, requesting that it initiate discussion with interested parties (Institute of Chartered Accountants in England and Wales, 1971b). Since price change accounting was already on its technical agenda, and the ASSC had mechanisms for consulting more widely than other committees of the Institute, there were obvious reasons for the Council to dispose of the business in that way.

The ASSC responded by holding a meeting with the regular members of its liaison group, including representatives of the Stock Exchange, the Confederation of British Industry (CBI), the Society of Investment Analysts and accountancy bodies not members of the ASSC itself, together with other parties including Benson, Parker and representatives of the Bank of England, the Inland Revenue and the Department of Trade and Industry. This took place on 10 May 1971 (Institute of Chartered Accountants in England and Wales, 1971a). The meeting was presented with a Discussion Paper (Institute of Chartered Accountants in England and Wales, 1971d) which included only a single proposal, a version of CPP. Sir Ronald Leach, chairman of the ASSC, suggested that contributors 'should touch only lightly on technical problems, if necessary reference would be made to *Accounting for Stewardship in a Period of Inflation*'. The representative from the Takeover Panel supported CPP; he was joined by the representatives of the Issuing Houses Association and (albeit rather late in the debate) the Stock Exchange. Parker, not surprisingly, also supported CPP. The representative from the Institute of Cost and Works Accountants (ICWA) said that his organisation was 'absolutely in favour' of CPP.

Benson's comments indicate his appreciation of the economic and social ramifications of inflation, which, he pointed out, was presenting problems not only for accountants but also for government, industry, the City and the unions. Because of this wide-ranging impact, he called for some sort of government inquiry to be set up. Renshall recalls Benson's contribution as a very forceful call for action: 'I remember him . . . delivering a stark warning about what inflation was now threatening to do to the economy - it was chilling stuff.'[10] Despite the title given to the report of the meeting, 'Financial Management and Accounting Under Inflationary Conditions', no other discussion of wider problems took place.

History as it might have happened

The Council's decision to refer Benson's letter to the ASSC was a decisive moment in the development of price change accounting. It limited the focus of the developmental process to external financial reporting, in which context the attractions of CPP were strongest. It placed the process in the hands of a group, the ASSC itself, which was dominated by practitioners: during the 1971/72 committee year, 11 of the 15 members of the committee were drawn from firms.[11] And it maintained the momentum behind the earlier secretariat decisions and the deliberations of the drafting committee.

Yet Benson's letter invited a much wider consideration of issues of financial administration and accounting generally and he was certainly well aware of the significance of these issues. As a former President and very influential member of the Council,[12] he might have been able to sway it towards an alternative approach.[13] Had a new working party been given the remit implied by Benson's letter, it would probably have had a wider representation from industry and other sectors. It would have been likely to call on a wider range of opinion and adopt a fresh start in working up proposals, albeit, no doubt, drawing on the work of the existing committee as one possible response. What are the chances that a different outcome might have eventuated?

While, as we have seen, there were several favourable comments on CPP at the liaison group meeting, the representative from the CBI was equivocal: he indicated that 'it was difficult to forecast how his members would react [but] he was sure, however, that any reaction would be vigorous.' His own suggestion was:

> Could we not concentrate on accounting for replacement of fixed assets [by implication using replacement cost], before going the whole way with CPP accounts?

Representatives from the Association of Certified and Corporate Accountants (ACCA) and the Institute of Municipal Treasurers and Accountants spoke, but without indicating a view on the acceptability of CPP, and those from all the government departments were careful to reserve their positions. It is far from clear how some of the participants supporting CPP would have reacted had a different method, or choice of methods, been proposed.[14]

There was, after all, a considerable body of support for replacement cost, the principal alternative to CPP. It had been discussed in the literature from the 1930s onwards and was advocated by professional accountants in the 1950s in various *forums*: for example, most of the papers at the relevant session of the 1952 International Congress on Accounting, held in London, supported this system (Mumford, 1979: pp. 99–101). Also in 1952, two accountancy bodies published separate reports advocating systems based on specific prices (replacement costs), the ICWA (Research and Technical Committee of the Institute of Cost and Works Accountants, 1952) and the ACCA (Taxation and Research Committee of the Association of Certified and Corporate Accountants, 1952). An opportunity to support replacement cost at the liaison group meeting was missed by the ICWA representative who, curiously, not only backed CPP but said that his Institute 'had themselves published a book on the subject some time ago' without mentioning that it advocated an alternative system. Perhaps he thought it more important to encourage progress, but, in view of what was to happen, it might have been better if he had stuck to the ICWA's original position.

After the publication of these reports the ICAEW invited a number of its fellow professional bodies to discuss whether an alternative to historical cost accounting might be developed but the talks broke down and both the Society of Incorporated Accountants and Auditors[15] and the ACCA published official statements of their own (Mumford, 1979). The Society encouraged 'the wider use of new conventions in calculating the profit shown in financial accounts' (Society of Incorporated Accountants and Auditors, 1954: p. 74) and suggested charging depreciation and the cost of maintaining essential inventory at replacement cost, with inventory shown at replacement cost in the balance sheet. The ACCA (1954) proposed LIFO for inventory and an adjustment to depreciation based on a specialised index reflecting sector-wide fixed asset prices. Although differing in detail, the overall content of the two recommendations is strikingly similar.

Thus there was well-documented support for replacement cost accounting from within the profession, including among professional bodies, dating from before Benson's call for action. Though the ICWA represented accountants in industry and commerce, the ACCA and the Society included substantial numbers of practitioners, so the advocacy of replacement cost was not limited to those bodies focusing principally on the 'daily struggles' of the entity. Prominent ICAEW members based in industry advocated replacement cost during the preparation of earlier ICAEW Recommendations which, in the event, did not propose any alternative to historical cost (Noguchi & Edwards, 2004).

A further documented source of support for replacement cost accounting that would have been available to a more open-minded working party was the actual preferences of companies. The ICAEW's annual Cambridge summer conference in 1971 was devoted to 'accounting for inflation' (*Accountancy*, 1971); speakers included several, for example H. Vermeulen of NV Philips and Eddie Weiss of Tube Investments, advocating replacement cost, some having had practical experience of the system. As it happened, the ICAEW secretariat had a particularly good source of information about company preferences, Chris Westwick himself:[16]

> Prior to joining the Institute's secretariat I had been working for the Centre for Inter-Firm Comparison . . . [W]e had been concerned to measure companies' efficiency in general and their return on assets in particular. In order to do this we had asked companies to revalue their assets and calculate their depreciation on a replacement cost basis using specific indices calculated by the Economist Intelligence Unit. We had found that this approach was well understood by our clients in industry who accepted the results as being relevant to their managerial decisions. We had never experienced any demand for a general price level or CPP adjustment approach.
>
> (Westwick, 1980: p. 357)

The attractiveness of CPP to auditors, and its apparent utility for the particular purpose of external financial reporting if defined in narrow terms, reinforced by *Accounting for Stewardship*, was an important *general* cause of the adoption of the system for ED8. But there is sufficient evidence on the historical record to suggest that *exceptional* causes included the decision to refer Benson's letter to the ASSC, rather than another group that might have taken into account a wider range of views and requirements. Substantial advocacy of replacement cost accounting, from authoritative sources, would surely have been considered by the group. Even the committee actually drafting ED8 had sufficient members from industry and commerce to mean that it might well have been receptive to alternative approaches to price change accounting in financial reports, given the stimulus to reflect on them.[17] Neither of the two most influential figures in the profession at the time, Benson and Leach, appears to have had strong views on the choice of method. Benson was much more concerned that some action should be taken than that any particular system be introduced.[18] It is likely that Leach would have been content with a more prescriptive version of an earlier, non-mandatory ICAEW recommendation (1952).[19]

Auditors' preference for CPP was based on reasoning which derived, at least in part, from concern not to impose on clients a change in accounting which would be disruptive and expensive. If preparers had indicated a strong preference for replacement cost, auditors would no doubt have accommodated themselves to the system. The expense and complexity of replacement cost might have encouraged the use of a small number of individual adjustments rather than comprehensive restatement, and limitations in the scope of the requirements, either of which would have made the system more palatable.

Would the government have established its inquiry even if ED8 had adopted CCA, so that the ASSC's proposals, whatever they might have contained, stood no real chance of coming to fruition? Indeed, might a CCA-based proposal even have triggered a response from government designed to secure CPP, for example with the motive of delaying implementation of a standard?

Tweedie and Whittington examine why the government intervened at some length (1984: pp. 75–78). Its concerns were: (a) that government backing for a standard might become necessary; (b) that the method chosen should be acceptable to the financial community as a whole; and (c) the implications for government policy. On the first and second points, we now know that a majority of preparers making submissions on ED8 did not support CPP (Westwick, 1980: p. 359) and there were indications that large companies were lobbying government to this effect. It is also likely that most of those civil servants with any technical insight into the problem would have been economists and thus more likely to think in terms of opportunity cost (and thus replacement cost) than CPP.[20] On the third point, any form of price change accounting draws attention to inflation and thus may add to inflationary pressure, for example by highlighting the need for price increases and higher tax allowances, but CPP particularly highlights the process of indexation and thus the scope for automatic compensation, for example in the tax system. The government itself, being a major borrower, was a primary beneficiary of the erosion of the real value of debt, a phenomenon explicitly revealed by CPP accounting.

Taking the government's concerns at face value, it would seem that an inquiry would have been much less likely to occur if ED8 had employed CCA. Since the system is more complex, it would have taken longer to develop, a feature which might have been attractive to the government. Only on the most cynical view of the government's motives – suppressing awareness of inflation for as long as possible – would it be likely that an ED based on CCA would have resulted in an inquiry designed to secure CPP, so as to cause further delay. The government's self-interest actually argues against CPP. Had ED8 adopted CCA, but an inquiry been set up nonetheless, and had the inquiry supported CCA, a standard could have been established rapidly because the draft would have been available as a model and the ASSC could have spent the period of the inquiry working on further development.

Impermissible speculations

Two categories of impermissible speculation are considered under this node. The first covers speculations addressing general causes insufficiently proximate to the event the cause of which is to be explained. If standard-setting machinery had not been established when it was – at the beginning of 1970 – it might not have been available to have Benson's letter referred to it, in which case something else would have had to have happened. But the establishment of the ASSC is not a sufficiently proximate cause to enter into this counterfactual history: too many other things might have turned out differently in the intervening period to enable us to analyse the impact on price change accounting with any reliability.[21]

The second category includes speculations for which there is no empirical basis. Given his influence in establishing the momentum behind CPP, it seems likely that, had Parker supported replacement cost accounting instead, this might have had a decisive effect. It is, of course, possible that he might have come to such a view: for example, replacement cost was advocated in the USA in a study published by the American Institute of Certified Public Accountants in parallel with one arguing for general price indexation, which he acknowledged as a source for *Accounting for Stewardship* (Tweedie & Whittington, 1984: p. 40 and p. 47). However, there is no evidence that he did ever consider advocating replacement cost and thus speculation about what would have happened had he done so fails Ferguson's criteria of plausibility.

Node 2: The Decision to Design a Comprehensive System in Response to the Sandilands Report

History as it happened

Work on designing what became ED18 was led by an Inflation Accounting Steering Group (IASG), chaired by Douglas (now Sir Douglas) Morpeth, and a secretariat headed by Chris Westwick. A decision taken early in its deliberations, and followed through without deviation, was to have a very significant effect on the nature of the system that was proposed. In the words of the group's secretary:

> At the start of the work . . . we decided that we would endeavour as far as possible to cover all the practical problems raised by the introduction of current cost accounting. We felt that if we did not do so we should be open to the legitimate criticism that we were putting forward something which was not practicable.
>
> (Westwick, 1980: p. 362)

The first consequence of this decision was a list of 25 'problem areas', allocated between outside experts and six main working parties (Morpeth, 1981: pp. 48–49; Tweedie & Whittington, 1984: pp. 110–111). Another significant pressure towards elaboration was that the IASG's terms of reference required it to take into account responses to the Sandilands report, and especially that from the Consultative Committee of Accountancy Bodies (CCAB) (*Accountancy*, 1976: p. 9; Tweedie and Whittington, 1984: pp. 106–107). This advocated an additional statement showing the amount necessary to maintain proprietors' interest in purchasing power terms, in effect preserving an element of CPP (Tweedie & Whittington, 1984: pp. 103–105). Although the IASG considered alternative approaches to meet the CCAB's point, it eventually arrived back at the CCAB's own suggestion (Tweedie & Whittington, 1984: pp. 112–121).

The result of the efforts of the IASG, its six working parties and its panel of outside experts, to cover all practical problems was very lengthy documentation. ED18 ran to 332 paragraphs plus an introduction and five appendices – nearly 100 pages in all (Accounting Standards Committee, 1976). The accompanying guidance manual (Inflation Accounting Steering Group, 1976a) contained nearly 300 pages, excluding appendices. It is difficult to believe that the scale of this documentation – ED8 ran to only 16 pages – had no effect on the way the system was perceived.

As the Sandilands proposals envisaged, implementation of ED18 was to be phased. Entities in Phase 1 corresponded almost exactly to those identified for the first phase by Sandilands and were to produce CCA financial statements for periods beginning on or after 1 July 1978 (five months after the target publication date for the standard announced in the ED). Phase 2 covered entities with turnover or total assets in excess of £1 million[22] and Phase 3 limits were set at one tenth of those for Phase 2. Deadlines arrived rapidly: 1 January 1979, only six months after Phase 1, for Phase 2, and a mere twelve months later for Phase 3 – that is for entities only a tenth of the size of those that would now qualify for Companies Act exemptions as small companies. Relaxation for companies with overseas operations was minimal: companies with over 50 per cent of their assets outside the UK and Ireland that would otherwise fall in Phase 1 were permitted to delay to Phase 2; smaller companies enjoyed no dispensation.

The ASC received an unprecedented volume of comment on ED18: submissions were received from 694 respondents in all. An academic analysis of these (Tweedie & Whittington, 1984: pp. 124–135) found that the most frequently expressed criticisms were: (a) complexity (59 per cent of respondents); (b) subjectivity (44 per cent); (c) speed of implementation (41 per cent); (d) expense (41 per cent); (e) the abandonment of historical cost (38 per cent); (f) the range of enterprises affected (26 per cent); and (g) the requirement that CCA statements should be the main financial statements (23 per cent). While, of course, some of the reasons given may not reflect respondents' real objections, on the face of it only two-fifths opposed price change accounting as such (category e). The most common objection was to a characteristic largely related to the decision to aim for a comprehensive system and two others (b and d) were also related to this decision; the extent of subjectivity followed from the range of assets for which CCA was required. Another two objections (c and f) relate to the scope and speed of implementation of the system.

Shortly after the publication of ED18, Morpeth stated publicly that the cut-off for exclusion from the standard would be 'increased considerably' (Morpeth, 1981: p. 52). At the conclusion of the exposure period, the IASG indicated that it intended to revise its proposals so as to, among other things, 'simplify [them] by, for example, placing more emphasis on the use of indices, omitting material on deferred tax and leases, etc.; [and] defer the implementation date' (Westwick, 1980: p. 364). But it was too late. Two members of the ICAEW, David Keymer and Martin Haslam, requisitioned a general meeting of the Institute to consider a motion rejecting the compulsory introduction of CCA (Westwick, 1980: pp. 364–365). The resolution was passed by a narrow majority: the votes of fewer than 2 per cent of members would have tipped the balance (Tweedie & Whittington, 1984: p. 136; Westwick, 1980: pp. 364–365). It had, though, become politically impossible for a standard to emerge in the normal way from ED18.

History as it might have happened

Could a simpler system of narrower scope plausibly have emerged from the efforts to design ED18? There is abundant evidence that it could. The IASG might, for example, simply have followed Sandilands' own recommendations.

In Sandilands' proposals for an initial standard (Sandilands, 1975: ch. 13) it was envisaged that the historical cost of stock would normally approximate to current cost; thus the CCA balance sheet would include stock at historical cost and, in those cases where the figure did not represent a sufficiently close approximation, current cost would be shown in a note. Because of the theoretical and practical difficulties involved, no departure from historical cost would be required for intangibles or for liabilities; assets held overseas would be adjusted using whatever method the directors judged appropriate.

Yet, in pursuit of its comprehensive system, the IASG included in ED18 requirements to show stock at current cost and to show intangibles at current cost where this could be established and otherwise to write them off via the profit and loss account. Investments were required to be shown at current cost although Sandilands had 'recognise[d] . . . that in practice it may take time to achieve this' (Sandilands, 1975: p. 186). Consolidated financial statements were required to include all subsidiaries on a CCA basis, although Sandilands was prepared to allow historical cost where CCA was 'not practical' (Sandilands, 1975: p. 186). ED18 included detailed requirements relating to goodwill, overseas operations and leased assets although in none of these areas had the ASC yet issued standards under historical cost accounting.

Although the Sandilands Report recommended that all companies use CCA 'as soon as practicable' (Sandilands, 1975: p. 166), it adopted a distinctly relaxed approach to achieving this. By contrast with the extended scope and short timescales of ED18, Sandilands offered no specific proposals to extend CCA beyond entities in the first phase. It referred specifically to the difficulties likely to be encountered by companies with large overseas operations and hinted that the initial standard might defer application to such preparers. The IASG actually had extensive discussions about restricting the standard to large enterprises but, ultimately, felt that it was not appropriate to promote different systems for large and small companies.[23] Had they drawn the line at specifying an initial phase for large enterprises they would merely have been proposing what was soon actually to be done.

Documented proposals for a less comprehensive system are also available from the period in which the IASG was deliberating. Three months before the publication of ED18, Paddy Custis (finance director of Guest Keen & Nettlefold, a company that had assisted in field testing the proposals) sent a letter to Morpeth:

> . . . I am writing to set out my thoughts in the hope that it is not too late to mobilise opinion to restore a sense of balance and realism into the situation.
>
> I fully accept the need for the statutory accounts to include an earnings statement which provides a reasonably reliable guide to the real earning capacity of the business and which clearly illustrates the net profit available for distribution after providing for the maintenance of the business in its present form. In my view this could be achieved by ensuring that:
>
> (a) the depreciation charge on fixed assets is assessed realistically by applying an agreed index or series of indices to the depreciation based on historic[al] values.
>
> (b) holding gains and stock profits are excluded . . .
>
> (Custis, 1976)

In the same month, the IASG drew up a note for the ASC in which it pointed out that it did not consider that it was for the group to decide whether CCA should be implemented in full – by implication, the decision was for the ASC. The note reports that the group 'believes it has a responsibility to provide a simpler alternative should it be decided that full implementation at the present time is inappropriate' (Inflation Accounting Steering Group, 1976b: paragraph 9.6; see also Tweedie & Whittington, 1984: p. 124, note 21). The scheme it suggested was to modify historical cost by measuring: (a) fixed assets and depreciation at replacement cost; (b) cost of sales at LIFO; and (c) stocks in the balance sheet at replacement cost with a transfer to reserves (paragraph 8.2). The paper concludes that:

> The Steering Group believes that the scheme for the modification of historic[al] cost accounts outlined [in the paper] would remedy a large part of the defects of those accounts without attempting to provide an all-embracing system of inflation accounting. This method has the advantage of being compatible with stock valuation practice in the US and elsewhere and it should also avoid the need for two sets of accounts since it would only represent modifications to historic[al] accounting practice. Accordingly should it be decided not to implement CCA in full the Steering Group recommends that the above modifications should be introduced (paragraph 9.7).

At the following month's meeting of the ASC, 'one or two members' argued for radical simplifications including the use of LIFO (Morpeth, 1981: p. 50). The ASC, however, decided to continue with the full system, including the additional statement inserted at the CCAB's insistence.

There is thus sufficient evidence to satisfy Ferguson's criteria that a simpler system, and one of more limited scope, was contemplated contemporaneously. The evidence of responses to ED18 suggest that such a system – especially one addressed only to large companies – might not have proved so unpopular as to trigger the extraordinarily rare occurrence of a 'grass roots' rebellion among ICAEW members. The general unpopularity of price change accounting among the profession was a *general* cause of the demise of ED18, but the detailed design of the system was the *exceptional* cause actually bringing it about.

Impermissible speculations

Counterfactual historians generally avoid proposing single, trivial, changes with momentous consequences – the "'Cleopatra's Nose" theory of history' (Ferguson, 1998b: p. 4, and see pp. 12–13) – because:

> while there is no logical reason why trivial things should *not* have momentous consequences, it is important to beware of the reductive inference that therefore a trivial thing is *the* cause of a great event.
>
> (Ferguson, 1998b: p. 12)

As we have seen, the vote at the ICAEW general meeting was close; furthermore, there is evidence that some of those voting were motivated by factors other than the acceptability of ED18, for example by a feeling that the Council had lost touch with its members (Westwick, 1980: pp. 364–365, and see, for example, Mathews & Pirie, 2000: p. 96, interview with Gladys Winch). It might be possible to identify some action of the ICAEW that upset some of its members in the run-up to the meeting, and about which there was documented evidence that a more sensitive response was considered, and then to argue that, had this alternative been adopted, the outcome of the meeting might have been different. This trivialises the exploration of cause and effect for at least two reasons: first, because the linkage between alleged cause and effect is remote, and secondly, because it is virtually certain that even a narrow defeat for Keymer and Haslem would have had the same consequence as the actual outcome.[24]

One, normally rich, seam of counterfactual speculation about an official enquiry, namely what would have happened had the government changed political complexion, is not available here because the government did in fact change – from Conservative to Labour – during Sandilands' deliberations. The incoming administration asked the committee to continue its work under the same terms of reference (Sandilands, 1975: pp. ii–iii) and endorsed its conclusions.

Node 3: The Reaction to the Defeat of ED18

History as it happened

In the aftermath of the Keymer and Haslem resolution, the ICAEW Council reaffirmed its support for CCA but called for 'a reappraisal of the approach' (*Accountancy*, 1977a: p. 4). The government, while also re-affirming its support for CCA, welcomed the Institute's call for a reappraisal (Accountancy, 1977b). In July 1977, the ASC issued a Statement of Intent, repeating its view that a comprehensive system was needed but announcing that, in the short term, it intended to develop simple guidelines for supplementing historical cost statements with information about depreciation and cost of sales in current cost, combined with an adjustment to reflect the effect of gearing. This was completed in November in the shape of the Hyde guidelines (Tweedie & Whittington, 1984: pp. 136–140); the information to be reported was as specified in the Statement of Intent. As implied by their name, the guidelines (Accounting Standards Committee, 1977) were voluntary; they were also of limited scope – applying only to quoted companies – and brief, running to only 24 paragraphs plus three one-page appendices. The principal shortfalls, by comparison with Sandilands, were the absence of balance sheet information, the limitation in scope, the status of the information as supplementary, and its non-mandatory nature. Approximately half the companies falling within the scope of the guidelines followed them in the first full year after their implementation (Institute of Chartered Accountants in England and Wales, 1980a: Table 4.2).

Meanwhile, the ASC continued to develop a comprehensive system of wide scope. The next exposure draft was much better received than ED18 (Tweedie & Whittington, 1984: pp. 143–145) and was converted to a standard (SSAP16, issued in March 1980) with no major changes (Westwick, 1980: p. 368). It applied to large companies, as defined in emerging company legislation – and thus more widely than Sandilands' proposal for an initial standard – as well as to listed companies; however, ED18's attempt to extend coverage to all financial statements intended to give a true and fair view was abandoned. It required a CCA balance sheet including current costs for intangibles, associates, investments including non-marketable securities, and goodwill on consolidation – all going beyond Sandilands. However, greater emphasis was placed on the use of indices and the standard was generally much more permissive than ED18 on the measurement of fixed assets (Westwick, 1980: pp. 366–368). At last, nearly ten years after work on ED8 started, and four and a half years after the publication of Sandilands, a standard on price change accounting had been secured. As we shall see, it was not to survive very long.

History as it might have happened

In judging the extent of the shortfall in Hyde against Sandilands, it needs to be borne in mind that Sandilands required current costs in the balance sheet only for fixed assets, with disclosure of the current cost of stock if materially different from historical cost. The difference in scope was limited to very large non-listed companies and the nationalised industries, which were really for the government to deal with. Given the limited extent of the shortfall, the unpopularity of ED18, the demonstrable workability and acceptability of the guidelines, and the government's public support for a reappraisal of approach, might the ASC have converted the guidelines to a standard rather than pursuing its more comprehensive approach? There is, indeed, evidence of a preference among some involved in the process 'to stand on the existing Hyde guidelines and go no further for some years' (Morpeth, 1981: p. 57) – actually an even more cautious approach.

Treating the guideline document as exposure of the proposals would have enabled a standard to be issued in, say, October 1978, 11 months after the guidelines and a year and a half before SSAP16 was issued.[25] One part of the Sandilands, shortfall – the voluntary nature of the pronouncement – would then have been overcome. In the short term, a standard would have been achieved more rapidly than was actually the case. More importantly, as we shall see, it is likely that it would have offered a more secure base from which to secure the long-term future of price change accounting.

Node 4: Action by the ASC in Autumn 1982

History as it happened
Several factors undermined SSAP16. May 1979 saw the election of a Conservative government with a fundamentally different approach to the battle against inflation: prices and incomes control was replaced by restrictive monetary policy. Whether for this reason or otherwise,[26] inflation fell; at the beginning of 1983 it dropped below 5 per cent for the first time in over a decade. The abolition of price control machinery in 1980 removed one incentive to employ CCA because the body responsible for monitoring levels of profitability for price control purposes had accepted CCA data. Some factors were internal to the standard-setting process. In a statement on its publication, the ASC undertook to 'maintain a standing sub-committee to monitor the ways in which SSAP 16 is being implemented and the changes that may ultimately be needed' (Accounting Standards Committee, 1980) and the speed and elaboration with which the monitoring machinery was established contributed to an expectation of impermanence (Pong & Whittington, 1996: p. 33). In mid-1982, Keymer and Haslem requisitioned another general meeting, calling for the immediate withdrawal of SSAP16. This time they lost, though by an even narrower margin (Tweedie & Whittington, 1984: pp. 147–148 and note 44). The narrowness of the margin, after intense lobbying, appears to have shaken confidence within the professional establishment (Pong & Whittington, 1996: p. 36).

The ASC's monitoring sub-committee (chaired by Tom Neville) was now taking the lead in the development of the next CCA pronouncement (Pong & Whittington, 1996: p. 36). An interim report was published in April 1983; the final report, in September, followed similar lines. The principal focus of discussion was the tension between insisting that all entities publish CCA information (universality) and the flexibility necessary to make such a standard palatable. Neville plumped for universal scope and flexible methods. After the ASC's consideration of the interim report, it published 'three points for general discussion' (Institute of Chartered Accountants in England and Wales, 1983: p. 23). These embraced flexibility but, while appearing to support universality, in fact opened the door to limiting the scope of the standard by suggesting that universality should be subject to a cost-benefit test. The final report of the sub-committee did not, however, take up this broad hint. In parallel with the Neville sub-committee, the ICAEW commissioned a series of research studies under the leadership of its Director of Research, Professor Bryan Carsberg (Carsberg & Page, 1984). Carsberg's summary report recommended differential reporting, on cost-benefit grounds, but a prescriptive approach so as to promote comparability.

Though the ASC sub-committee favoured universality, in December 1983, the ASC decided to adopt a differential but prescriptive model (Accountancy, 1984a). This decision was reaffirmed by the ASC in February 1984 (Accountancy, 1984c), despite the chairman of the sub-committee having persuaded the ASC's planning committee to recommend restoration of universality, a decision which itself received wide publicity (*Accountancy*, 1984b). Whether differential reporting was compatible with the true and fair doctrine was seen as problematic by the ASC (Davison, 1985: p. 11). In March 1984, it sought counsels' opinion on whether a cost-benefit criterion could be applied to justify differential reporting and the result confirmed that it could (Pong & Whittington, 1996: p. 39). Following its receipt, the ASC issued another Statement of Intent setting out the lines it would be taking on the development of a standard, which would be mandatory only for public companies and would permit only limited choice. ED35, issued in July 1984, followed this position. It was not well-received (Pong & Whittington, 1996: p. 40).

Unfortunately, although the CCAB bodies agreed that action was needed, they could not agree even on what form the next pronouncement should take: consultations in March 1985 showed that the Chartered Institute of Cost and Management Accountants (formerly the ICWA) favoured a standard (although they, like the ACCA, had already publicly announced that they would veto a standard based on ED35); the ACCA and the ICAI preferred a (non-mandatory) Statement of Recommended Practice; and the ICAEW and the Institute of Chartered Accountants of Scotland wanted a revised exposure draft (Accountancy, 1985c; Pong & Whittington, 1996: p. 42). In March, ED35 was withdrawn and, in June, SSAP16 was made non-mandatory. In the same month, the ASC agreed a new exposure draft, provisionally numbered ED38, the scope of which was now restricted to listed companies. Despite the limited scope, considerable flexibility would be allowed. No balance sheet would be required (*Accountancy*, 1985b).

The ASC decided that publication of the draft should be deferred until it was clear that there was 'a reasonable degree of support' for its contents (*Accountancy*, 1985a). Consultations showed that it enjoyed considerably more support than ED35 – Pong & Whittington's analysis (1996: pp. 41–44) suggests that 25 per cent of respondents gave support or qualified support to ED35 while for ED38 the figure was exactly twice that. However, this level of support was regarded as insufficient to proceed to exposure. The ASC announced that it was recommending withdrawal of SSAP16.[27] No further attempt to introduce price change accounting was made.

History as it might have happened

Could swift and decisive action by the ASC, for example in the autumn of 1982, backed up by concerted support from the CCAB bodies, have secured the adoption of a standard that would have been complied with by a reasonably substantial proportion of those to whom it applied? After all, the second ICAEW resolution was defeated, and there was evidence that some of the support for the resolution, as with the earlier vote, was motivated by anti-establishment sentiment (Pong & Whittington, 1996: p. 36). Or was the cause hopelessly lost? An exposure draft issued at this time would probably have been numbered ED30[28] – let us call it ◇ED30.[29]

There is certainly documented evidence of support for differentialism. Within weeks of the second Keymer and Haslem resolution, Ian Hay Davison took over the chairmanship of the ASC. A profile of him at the time suggested that 'the trial period for SSAP16 will be ended at the earliest possible date' (International Accounting Bulletin, 1982: p. 5) and speculated that it would be replaced by a simple pronouncement addressed only to large companies. Although the article is not quoting him at this point, it seems likely that the speculations were based on his comments. This was backed up in early 1983, in the ASC's response to the interim Neville report. Given the primitive state, conceptually and practically, of mechanisms for measuring the costs and benefits of accounting standards (Meeks & Meeks, 2001), there would appear to have been considerable latitude for setting the cut-off point. Counsel's opinion could have been obtained earlier. Compliance with SSAP16 fell less rapidly among the larger listed companies in the ICAEW annual survey: in 1882/83 the proportions were virtually identical between large and medium-sized listed companies but by the following year there had been a drop of 14 percentage points for large but 33 points for medium-sized companies (Institute of Chartered Accountants in England and Wales, 1984: p. 84). This suggests that compliance among small listed companies was even poorer. It seems likely that a standard addressed only to large listed companies would have encountered less resistance.

Although differentialism and prescription appeared to go together, this assumption was not shared by all contributors to the debate and the ASC's 'three points' statement itself embraced differentialism and flexibility. ED38 would have permitted a considerable degree of flexibility and did not require a balance sheet. These concessions could have been adopted in ◇ED30.

A flexible ED of limited coverage could have been issued in 1982 and the political scope for converting it into a standard may well have been available. The exceptional causes of the course of events as they occurred included the inability of the key parties involved to take a policy decision, stick to it, and show some degree of solidarity. An astutely managed retreat from SSAP16 might have maintained the momentum behind CCA, and compliance among large companies, at least for two or three years. Whether that would have been enough to alter the ultimate outcome is discussed in the next section.

Would any of the Alternatives have made a Difference in the Long Term?

Vested Interests and Corporate Taxation

During inflation, price change accounting reduces the profits of most entities and it is often considered that management will resist its introduction simply because it presents a poorer impression of performance (Davison, 1984: p. 5; Morpeth, 1981: p. 51). There are, however, also incentives to management to support price change accounting; for example, it can justify lower dividends (Tweedie & Whittington, 1984: p. 308).[30] One large company, Ford (UK), was a front-runner in developing CCA partly because its management accepted that it was unrealistic to claim to trade unions that high wage claims could not be afforded while reporting substantial historical cost profits.[31] Two major incentives to support CCA recognised by both researchers (1984: p. 307; 1997: p. 173) and participants (see, for example, Davison, 1984), were the prospect of CCA-based taxation and the actual use of CCA information in negotiating price increases under price control regulations. It follows, according to both Tweedie and Whittington, and Davison, that the government's apparent unwillingness to base corporation tax on profits reported in current cost financial statements, and the abolition of price controls, were heavily implicated in the demise of price change accounting. The abolition of price controls clearly removed one particular incentive, for some preparers, and at a particular point in time, but, in itself, makes only a limited contribution to explaining the course of history. The question of CCA and corporate taxation is more complicated.

By 1974, two adjustments, accelerated capital allowances and stock relief, provided a substantial cushion against the effects of inflation on corporate taxation.[32] In introducing the latter measure, the Chancellor of the Exchequer indicated that it was intended to be temporary but that the adoption of CCA accounting might permit some relief to be made permanent. This was reiterated by subsequent Chancellors of both parties (Pong & Whittington, 1996: p. 35).

The government's 1982 Green Paper on corporate taxation (HM Treasury, 1982) has been cited as evidence of the government's unwillingness to link corporation tax to CCA profits (Pong & Whittington, 1996: p. 35; Tweedie & Whittington, 1997: p. 153), which in turn is taken to be a primary cause of the demise of CCA in financial reporting. Yet it is far from clear that the use of CCA accounting for corporation tax would have resulted in companies adopting CCA voluntarily for their financial reports. Some factors would have pulled in this direction; for example, once the cost of maintaining CCA systems has been incurred, it would cease to be a consideration against using CCA in financial reports. Other negative factors would have remained, including the reluctance of managements to report lower profits. To ensure that the change in tax regime resulted in companies using CCA in financial statements 'voluntarily', it would be necessary to withdraw the tax reliefs for inflation, so as to ensure that historical cost taxable profit virtually always exceeded CCA profit; to require that the same method be used for tax and financial reporting; and to apply the same tax rate whichever method was used. It does not seem likely that a government would be prepared to allow its corporate tax system to be high-jacked to drive financial reporting in this way.

The Green Paper's discussion began by emphasising that it 'proceed[ed] on the assumption that any changes would have to be made on a revenue-neutral basis and financed from within the corporate sector' (122). A calculation of the revenue neutral effect of employing CCA was provided (pp. 48–49). There would have been a very significant shift in the burden: manufacturing and distribution would have paid about £150 million more, the financial sector about £125 million less. The largest element of this shift came from relief for maintaining monetary working capital, a much greater benefit to the financial sector than manufacturing. Suddenly a CCA-based corporation tax must have seemed much less attractive to most industrialists.[33]

On the issue of using CCA-based accounting depreciation for tax purposes, the Green Paper drew attention to the subjective nature of the estimation of asset lives and the determination of current cost and suggested the use of statutorily prescribed standard values, designated by class or generally. The chapters on cost of sales and monetary items follow similar lines. In the case of monetary items, the subjectivity problem is compounded by the complex nature of the adjustments: for example, monetary working capital includes financial assets needed for the operations of the business, but not others. If this classification affected the tax position, it would have to be policed closely. Since financial assets held as private investments did not attract relief, there would be another dividing line to be policed in the case of unincorporated businesses. The concluding chapter was, as would be expected given its 'green' status, written in neutral terms. The problem of subjectivity is not mentioned but the assumption of revenue-neutrality is stressed.

The claim that 'the Green Paper on Corporation Tax made it clear that CCA was unlikely ever to be used as a base for corporation tax, because it was too subjective' (Tweedie & Whittington, 1997: p. 153) is justified only if a CCA base is understood to mean literally taxing profits as reported in CCA financial statements. A parallel system of 'shadow' standardised allowances was not ruled out. It could have been made palatable to industry; for example, monetary items might have been left out of the system, on the grounds of equity and complexity, avoiding the biggest element of the redistributive effect. The possibility of a parallel system in the future would have provided an incentive to companies to adopt

CCA for financial reporting: it would have added to the pressure on the government to move to CCA-based taxation or at least preserve the reliefs already available. Had CCA-based taxation been adopted first, moving to CCA-based financial reporting would have helped to lock in the new tax system and preserve reliefs should inflation fall.[34]

While it is possible that the government was so concerned about subjectivity that it wished to avoid even a parallel system, a more plausible conclusion is that an administration confident that it was going to bring inflation under control did not want the upheaval of a shift in the tax base, and used the threat of taxing industry more heavily to discourage change. Did preparers reject CCA because of the Green Paper? Even if the government was rejecting CCA-based taxation, however achieved and whatever the rate of inflation (and this is not what the Green Paper said), CCA-based financial reporting would have applied pressure to maintain the existing reliefs. That this incentive was not in itself strong enough to result in the adoption of CCA for financial reporting scarcely deserves to be described as a *cause* of its rejection.

Suppose the Green Paper meant what it said. If preparers believed before 1982 that an *integrated* system was available, and could not see, after 1982, that a *parallel* system would have been (approximately) as good, the tax-related exceptional cause of CCA's demise appears to be a misunderstanding by preparers, not a decision of government. It seems more likely that the government wanted to discourage change for the reason set out above and that, if preparers used the tax argument to justify resistance to CCA, it was an excuse, not a motive. While the failure of government, over the years, to lock CCA into profit calculations for tax and financial reporting purposes may be a general cause behind the demise of CCA, the 1982 Green Paper was an exceptional cause, if at all, only by providing camouflage.

Inflation

A number of studies have shown that interest in price change accounting is strongly associated with the level of inflation (for example, Archambault & Archambault, 1999; Mumford, 1979). ED8 was drafted as inflation approached 10 per cent and Sandilands and ED18 emerged with inflation in the 15 to 25 per cent range. After peaking in May 1980, inflation abated: at the beginning of 1983 the rate dropped below 5 per cent for the first time in over a decade.

The close connection between levels of inflation and efforts to achieve price change accounting might suggest that the early 1980s simply saw another historically inevitable repetition of the cycle in which price change accounting is ultimately stymied by 'eventual inaction as the crisis motivating reform becomes less pressing' (Mumford, 1979: p. 104). But this is to ignore an important feature of history as it actually happened: price change accounting never achieved a secure foundation in financial reporting practice. CCA retains at least some of whatever superior relevance it has when there is little or no inflation so long as some specific prices are changing, and even modest rates of price change can have a substantial impact on long-lived assets. During a period of total price stability, price change accounting reports the same accounting numbers as historical cost accounting and thus remains valid. And, of course, inflation may return. What would have happened, had CCA achieved a secure foundation?

Table 1 shows the rate of inflation and the percentage of listed and other large companies publishing CCA financial statements from 1973 to 1987. The first year in which a

Table 1. Inflation and the publication of CCA financial statements

Year	Inflation[a] %	Companies publishing CCA financial statements[b] %
1973	10.6	0
1974	19.1	0
1975	24.9	0
1976	15.1	5
1977	12.1	40
1978	8.4	53
1979	17.2	57
1980	15.1	78
1981	12.1	94
1982	5.4	80
1983	5.3	59
1984	4.6	34
1985	5.7	5
1986	3.7	3
1987	3.7	2

Sources: Hanson (1989); Pong & Whittington (1996); and *National Statistics* RP04.
Notes: [a] Percentage increase in the Retail Price Index for the year to December; [b] Based on company annual reports circulated to shareholders during the year to 30 June of the following year. Companies publishing CPP financial statements and price level statements classified as employing 'other' methods in the original source are excluded. Coverage of the sample varied through time but essentially included listed and other large companies. The series was no longer published in the original source after 1987.

mandatory standard (SSAP16) applied generally was 1980. By then, the publication rate was already over 50 per cent; adoption of SSAP16 increased compliance to over 75 per cent and in the following year virtually all companies required to do so published CCA financial statements. This behaviour is consistent with preparers' responses to opinion surveys, which generally acknowledge the need to use price change accounting when inflation reaches high levels; for example, a MORI survey showed that 68 per cent of preparers considered that they would 'become concerned at the reliability and accuracy of historic[al] cost accounts' at an inflation rate of 11–15 per cent, the range applying in 1981 (Market and Opinion Research International, 1987: p. 3). In 1982, compliance began to fall but, despite declining inflation, the Green Paper, the abolition of price control and the second Keymer and Haslem resolution, it remained at 80 per cent in 1982 and even stood at 59 per cent the year after that. Furthermore, in those years compliance by large listed companies ran at 90 per cent and 78 per cent respectively (Institute of Chartered Accountants in England and Wales, 1983: p. 30, 1984: p. 84).

What would compliance rates have been, had a mandatory SSAP16-type system, *a fortiori*, a more limited system of narrower scope, been adopted in 1974 (following exposure in the equivalent of ED8) or 1977 (the year in which a standard developed directly from a post-Sandilands ED would have been available)? The evidence suggests that, within a year of such a standard becoming mandatory, and provided that inflation is running in double figures, compliance approaches 100 per cent. With inflation at around 5 per cent, compliance remains well over 50 per cent across all categories and at over 80 per cent (averaging the years 1982 and 1983 in history as it actually happened) for large listed companies. And these levels came about *despite* the pronouncement following years of equivocation and the factors listed in the previous paragraph. How much better would compliance have been in the absence of these factors?

Had a limited system of narrow scope been adopted in 1974, the second year of its operation (equivalent to 1981 in history as it actually happened) would have fallen in 1976, and there would have been six years of inflation in double digits (subject only to a minor one-year dip in 1978) – and thus, possibly, six full years of compliance at nearing 100 per cent – before the downturn of 1982. Among large listed companies there would probably have been seven years of compliance (on the basis that they would have complied in the first year of mandatory implementation) and little falling off for a further two years after 1981 – nine years in all. Had the system been adopted in 1977, the equivalent figures would have been three years for all preparers but six for large listed companies. Had ◇ED30 been issued in 1982, and thereby maintained the momentum of CCA for large listed companies, at least four years of compliance by such entities might have been secured.

On the first of these scenarios and, for large listed companies, on the second and, perhaps, the third, it seems probable that the system would have had time to bed down before falling inflation created the opportunity to call for reversion to historical cost. It is arguable that many of the concerns of preparers and auditors would have abated as time passed. Concerns about subjectivity, felt more strongly by auditors than management (Tweedie & Whittington, 1984: p. 132), might have diminished as those involved became more familiar with the system. Many of the expenses associated with CCA are one-off costs of transition (Peat, Marwick, Mitchell & Co., 1982: pp. 89–90), so that once the system is in place they cease to be a consideration; recurrent costs are not generally separately identified and thus become less visible over time. By the late 1970s, revaluation of property was a common feature of historical cost accounting: for example, in 1979/80, just over a quarter of the companies in the ICAEW annual survey had revalued some property in the reporting period and 79 per cent carried some property at a valuation (Institute of Chartered Accountants in England and Wales, 1980b: pp. 84–87). Presumably neither the subjectivity nor the expense of the exercise concerned preparers or auditors unduly.

Incentives to support CCA, for example to justify lower dividends and wage settlements, would have been stronger in the early years, with inflation at higher levels. What was widely regarded as the principal underlying motivation for objections to CCA by preparers, namely that 'many company managements did not like the effect of the proposals on reported profit' (Morpeth, 1981: p. 51) actually resulted from a *combination* of CCA and significant inflation, so that, as inflation subsided, this objection would have been likely to diminish. Thus, as time passed, incentives and disincentives would have weakened together. In any event, the impact on investors' and others' attitudes is likely to be greatest in the years immediately after the switch, declining as users of financial statements become familiar with the new system and appreciate that the reduced numbers derive from a different measurement system, not a change in an economic variable.

A highly significant factor comes into play from the establishment of a 'track record' of CCA information. A common theme of those involved in the development of CCA (Westwick, 1980: p. 368) and academic commentators is the 'absent user' (Pong & Whittington, 1996: p. 52), that is the lack of significant pressure from the user community for the introduction and preservation of CCA. While silence might indicate users' preference for historical cost, the absence of user objections to ED18 and the level of support for CCA from the small number of users who commented (Tweedie & Whittington, 1984: p. 128) suggest that this is not the case.

A survey of institutional users' attitudes to CCA conducted a couple of years after the adoption of SSAP16, as part of the Carsberg initiative, concluded that:

> At present little use is made of the current cost accounts . . . The major reason given for this is that the rest of the market does not use such information and analysts do not want to be out of line with the market since this is unlikely to prove advantageous, at least in the short term. This is consistent with the traditional view of behaviour in the market summarised by the term 'herd instinct' and it creates a powerful force which works to preserve the *status quo*. Other important reasons, which perhaps prevent wider use of current cost accounting information at present, are the weak support given to the system by companies' management and brokers' analysts, the lack of knowledge and understanding of SSAP16 on the part of analysts, the lack of sufficient years' figures to provide a long-term trend, the analysts' belief that they can derive the same information from funds flow data and the likelihood of inflation being reduced to a level at which analysts consider that it will no longer present a problem for financial reporting.
>
> (Boys & Rutherford, 1984: p. 124)

Widespread production of CCA figures for a significant number of years would have created the conditions necessary to break the dominance of historical cost, for example by providing the data for trend analysis. Had CCA data become available on a regular basis before inflation fell, the disincentive to master the new system because it was thought unlikely to endure would not have arisen. As some analysts began to use CCA information, others would have had an incentive to follow. As trend analysis based on CCA entered analysts' routines, they might have become unwilling to lose CCA data. Users' concern about historical cost remains significant at rates of inflation quite modest by the standards of the early 1980s: the MORI survey quoted earlier showed that in 1987, with inflation running at less than 4 per cent, 26 per cent of users thought it 'very important' that 'financial statements should indicate the effects of increasing prices on [companies'] operations' and a further 42 per cent thought it 'fairly important' (Market and Opinion Research International, 1987: p. 6) Thus a quite different dynamic to users' attitudes might have become established – and continued to operate as inflation fell.

International influences

Tweedie and Whittington point out that 'possibly the most striking pattern' (1984: p. 315) of price change accounting events internationally is a high incidence, across the English-speaking world, of an initial attempt to introduce CPP being followed by government intervention, an attempt to introduce CCA, and the demise of the system. This might be interpreted as evidence of historical determinism were it not for the likelihood that developments in one country influence others, so that methods chosen by 'early adopters' spread by diffusion. The UK and the USA led the rest of the English-speaking world along both the path to, and that away from, CCA (Tweedie & Whittington, 1997: pp. 172–173). Further, the first UK exposure drafts proposing CPP and CCA preceded those in the USA by over a year in each case, as did the withdrawal of mandatory price change accounting.[35] Hence, it is more likely that, had history run a different course in the UK, events would have turned out differently elsewhere, than that events in the UK were driven by developments in other countries.

Conclusions

Evidence satisfying Ferguson's criteria is available to support speculation that CCA accounting could have been adopted before Sandilands, and that the pronouncements actually issued in pursuit of CCA could have been different in the comprehensiveness of the system they required, the scope of their application, and the flexibility of their operation. Had a politically acceptable compromise been reached earlier, a significant period of substantial compliance could well have eventuated.

As a result, a quite different dynamic might have become established: users would have come to value CCA information; preparers and users would have become familiar with the different accounting numbers, so that preparers might have been less reluctant to reveal them; the government might have legislated to bring a small number of recalcitrant preparers into line, making a subsequent retreat from CCA more difficult;[36] the Stock Exchange, like the government, more willing to control occasional non-compliance than lead the way (Pong & Whittington, 1996: p. 43), might have mandated CCA via the listing agreement; a parallel system of taxation might have been introduced, locking CCA into both systems; and an initially skeletal system might have evolved into something more comprehensive in scope and method. Since CCA functions perfectly well when the price level is stable, and is arguably necessary if specific price changes occur within overall stability, the argument for dismantling the system, once it is established, has limited force. This is especially so if it is considered that inflation may return.

This argument is not presented as a proven thesis. Apart from any other consideration, some events illustrate the complex nature of historical probability referred to earlier. It is possible that some of the 'false starts' were necessary preconditions to later developments: perhaps, for example, without the long manual accompanying ED18 to educate them, preparers would have found the much shorter Guidance Notes on ED24 difficult to follow and would have criticised the failure to work out a fully specified system (Morpeth, 1981: p. 59).[37] The scope for using specific price indices extensively was greatly improved when, following Sandilands, the national statistical service increased the supply of official indices relevant to CCA (Westwick, 1980: p. 361); perhaps this would not have happened without an official recommendation, so that the profession alone would have found it difficult to adopt this simplifying methodology.

The argument of the paper does, however, represent a worthwhile speculation that should inform historical accounts of the causes of the failure of the CCA revolution. While the inflation rate is an important feature of the *context* of price change accounting, the decline in inflation from 1982 constitutes an exceptional cause of the failure only because it combined with the recency and instability of the CCA regime to encourage resistance. If the Green Paper on taxation featured as an exceptional cause it was either as a result of a misunderstanding by preparers or by providing further cover for a retreat motivated by other factors. The abolition of price control removed one specific inducement for some preparers but came about only in the context of reducing inflation. Two features of the general context, a degree of resistance to CCA on the part of preparers, and an inertial contentment with historical cost on the part of users, combined with the recency and instability of the regime, led to the demise of CCA. The recency of the regime was a result of particular choices about the form and structure of price change accounting, for example those made at the nodal points examined in this paper; the instability of the regime was a result of the management of the standard-setting process by the CCAB bodies and other parties. Had choices been different, as they plausibly might have been, especially if the alternative decisions had come early enough for the poor management of the process to matter less, the UK might still have a CCA-based system of financial reporting.

Do these conclusions matter? First, it is important that accounts of this highly significant aspect of the history of accounting standardisation should record the causes of the demise of CCA correctly. Second, the analysis demonstrates the important contribution made to the success of standard-setting by decisions about approach, scope, the specifics of method, the construction of documents, and so on – what might be called the *tradecraft* of standard-setting – and by the management of the process. Third, by demonstrating the importance of tradecraft and management, the analysis underpins arguments offered by previous commentators on price change accounting in favour of better resourcing (see, for example, Westwick, 1980: p. 371); a more systematic approach to field-testing (see, for example, Westwick, 1980: pp. 362–363); and better and more extensive research, especially before a topic reaches crisis stage (see, for example, Mumford, 1979: p. 104).

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Notes

1. For a comprehensive survey of the history of price change accounting, see Tweedie and Whittington's book-length study (1984) and their subsequent article (1997) completing the story.
2. For example in Tweedie and Whittington's (1997) analysis of 'broad historical factors' (174) resulting in the end of the current cost revolution, these two influences are argued to have had the main effect in the UK. See also Davison (1984).
3. For an excellent survey of the history of counterfactual methods and their methodological underpinning, see Ferguson (1998b).
4. This helpful suggestion was received from a referee.
5. Interview with Frederick Bleasdale (member of the drafting committee), 21 May 2005.
6. A similar argument is made by Tweedie and Whittington (1984: p. 48) in respect of a slightly later document.
7. Interview with Chris Westwick, 10 July 2002.
8. Membership is listed in Westwick (1980).
9. Personal communication to the author, 25 April 2005.
10. Interview with Michael Renshall, 17 June 2002.
11. See File 5/3/5, ASC Archive, John Rylands Library, University of Manchester.
12. Interview with Robert Willott, 10 June 2002.
13. Noguchi and Edwards (2004) document manoeuvres within the ICAEW to suppress public advocacy of price change accounting in an earlier period but also show how supporters of a more active stance, including Benson, continued to press for action.
14. See the discussion of the comments of the ICWA representative below.
15. This body's members were absorbed by the three Institutes of Chartered Accountants in 1957.

16. In history as it actually happened, of course, Westwick was tasked to support the ED8 drafting committee by continuing to develop a document based on previous decisions and 'as a new member of the secretariat [felt he] was in no position to suggest that the committee should reconsider its basic decision' (Westwick, 1980: p. 357).
17. We have seen that the decision to adopt CPP seems to have pre-dated the establishment of the committee.
18. Interview with Michael Renshall, 17 June 2002.
19. Interview with Sir John Grenside, 27 March 2002.
20. McRae and Dobbins (1974) suggest that civil servants generally favoured CCA.
21. Although the period between the establishment of the ASSC and Benson's letter was short, the political pressures under which the decision to set up standard-setting machinery was made (see, for example, Zeff, 1972: pp. 33–40) suggest that the consequences of a different decision would have been substantial.
22. Approximately £5.5 million at 2005 prices. The turnover limit (adjusted for the change in price level) corresponds almost exactly to the current statutory cut-off for small companies.
23. Interview with Sir Douglas Morpeth, 4 July 2002.
24. A second general meeting, called by Keymer and Haslem and concerning price change accounting, did result in a narrow margin of victory for proponents of the system – but had much the same effect on the momentum of the pronouncement concerned as their first. See below.
25. Based on the actual delay between the subsequent exposure draft (ED24 - April 1979) and the standard (SSAP16 – March 1980).
26. For an analysis of other possible reasons, see Gilmour (1993).
27. The statement was issued as TR604 and is reproduced in *Accountancy*, February 1986, pp. 18–19.
28. ED29 was issued in October 1981 and no further drafts were issued until October 1982.
29. Borrowing the logical symbol for possibility.
30. Watts and Zimmerman (1978) present US data suggesting that, overall, large companies appear to favour price change accounting.
31. Interview with Stanley Thomson, Finance Director of Fords at the time, 21 January 2003.
32. The reliefs are conveniently summarised in Institute of Chartered Accountants in England and Wales (1989: p. 25).
33. There was also an equity issue, since private individuals are not given relief for the effect of inflation on monetary items held as personal financial investments (HM Treasury, 1982: p. 51).
34. Different incentives would apply in the event of deflation, making current cost profit generally higher than historical cost profit.
35. The US ED proposing CPP was issued in December 1974 (Tweedie & Whittington, 1984: p. 43). A US ED proposing CPP or CCA was issued in December 1978 (Tweedie & Whittington, 1984: p. 155). The US standard withdrawing SFAS33 was issued in December 1986 (Tweedie & Whittington, 1997: p. 161). The US ED proposing CPP was issued in December 1974 (Tweedie & Whittington, 1984: p. 43). A US ED proposing CPP or CCA was issued in December 1978 (Tweedie & Whittington, 1984: p. 155). The US standard withdrawing SFAS33 was issued in December 1986 (Tweedie & Whittington, 1997: p. 161).
36. Failing this, at least it would have been much easier to argue, following the 1983 counsels' opinion, that CCA figures were necessary to show a true and fair view.
37. Though the material could, perhaps, have been published as background papers to a much simplified exposure draft and set of guidance notes.

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