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UK ACCOUNTING REGULATION: AN HISTORICAL PERSPECTIVE

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AN HISTORICAL PERSPECTIVE

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Accounting regulation in the United Kingdom has arisen as a response to social and economic factors as well as individual events. This paper traces the way in which regulation has developed both by governmental and professional actions. The factors behind regulatory change are in many cases unique to the United Kingdom and the paper concludes that it is these very factors which differentiate the control of accounting from the institutions and methods used by other countries.

Introduction

Accounting regulation in the UK follows a model of regulation quite unlike that of other countries. To appreciate the differences it is important to understand the origins of such regulation, by examining the history of the practices, thought and context of accounting. The justification for the historical emphasis could follow one of the three approaches described by Napier (1989) as

- understanding the past
- contextualising accounting and
- the new positivism.

Initially, understanding the past might appear to be a sterile, albeit interesting pastime. But such, studies may in fact impinge upon other areas of knowledge. To understand the present, Aristotle would have justified this approach - ‘if you would understand anything, observe its beginnings and its development’. The philosopher Santayana was more specific ‘those who do not remember their past are condemned to re-live it’. What we consider now as new practices and problems may be seen to have their origins in past centuries. In a study, Noke (1991) has suggested that agency theory may be demonstrated through a study of manorial accounts dating back to the 14th century. Window dressing and off-balance sheet finance which was the subject of regulation in the 1980’s in the United Kingdom was practiced first by the Popes in the twelfth and thirteenth century to overcome the usury laws. Even older than these examples are the foreign exchange translation problems identified in the accounts for the building of the Parthenon in the 5th century BC.

Contextualising accounting is the recognition that accounting is not practised in a vacuum. It reflects the social and economic environment in which it exists. Hopwood (1987) is critical of the traditional technical based study of accounting for failing to investigate underlying processes and forces. Modern schools of thought utilise the works of Michel Foucault to enable an analysis to be made of phenomena occurring within accounting development. Such studies use the notion of a discourse of accounting which provide the framework for recognition of these phenomena. This enables us to control development and exercise power through knowledge. Whereas the contextualisation of accounting is more relevant to explaining such power relationships through a study of management accounting, perhaps its use within financial accounting is at present limited to explanations only, but may be capable of being developed within such frameworks as economic consequences.

The new positivism 'views the objective of theory as explaining and predicting accounting practice' (Napier P 247). Much of the application of this approach relies on the use of empirical data to test theories. Accounting history then becomes the vehicle by which accounting theory can be assessed. There are many critics of positivism, because of the way in which the data is assembled and used, however if positive accounting theory can be underpinned by accounting history, and if that theory can be used to both explain and predict, then historical studies would appear to be self justifying.

The relevance of the historical approach to explaining current UK regulatory practice can be supported through any of these three rationales. Inherent problems of accounting do not disappear unless a long term solution is found, and even then it must be appreciated that over time this solution may change. Understanding that accounting is a social process is fundamental to appreciating both the current regulatory framework in the UK as well as international differences, from both theoretical and institutional viewpoints. If understanding the past and contextualising accounting helps to explain or even predict accounting practice then this approach needs no further justification.

The Early Years

Where a subject is to be examined from a historical perspective, then the starting point has to be established. In Britain, up to the 17th and 18th centuries which marked the transformation from an agricultural based economy towards mercantile and manufacturing activities, economic units tended to be small with the owner of the enterprise being aware of what was happening and therefore having little need of such refinements as the measurement of profits or the production of periodic statements of wealth. One of the main purposes of accounting was pure record-keeping with records being used by the owner for such purposes as monitoring of debts or checking the honesty of employees. In an economy where taxes were not levied on profits, and ownership structures were simple, accounting could be kept outside the public domain.

This was to change in the period after the industrial revolution when the growth in enterprise size brought about the separation of ownership and management. The original function of record keeping now had to be expanded to incorporate reporting to owners who were not directly involved in management. Chatfield (1977) describes how industrial managers needed new techniques such as asset valuation and profit calculation. During the 18^{th} and early part of the 19^{th} Century, enterprises could only be formed by specific acts of

Parliament which meant that this particular form of incorporation was both lengthy and expensive and thus applied only to very large companies. In 1844, incorporation of businesses by registration was made possible by the Joint Stock Companies Act, although initially shareholder liability was unlimited. Books of account had to be kept, a ‘full and fair’ balance sheet was to be prepared and presented to the meeting of shareholders as well as filed with the Registrar of joint stock companies. However, there was no requirement for the preparation of a profit and loss account and neither the form nor the content of the balance sheet was laid down. Auditors had to be appointed with full access to the books of account and a report was to be prepared for the annual general meeting of shareholders. The lack of detail on accounting matters covered by the act has been explained by Edey and Panitpakdi (1956) as:

• a desire not to interfere too closely in matters of private enterprises,

• an undeveloped state of accounting techniques, and

• the absence of an established code of auditing rules.

Indeed at that period auditors were appointed from among the body of shareholders and often had to seek professional advice for the execution of their duties. Although accounting techniques were to deve1op over the coming decades, the desire of the state not to interfere too closely, prevailed. This occurred during the years of laissez-faire where Edey (1979) describes how great weight was laid down on freedom of private enterprise from control. This attitude was endemic in UK regulation and its effects can be seen in legislation through to the mid to late twentieth century

Despite the provision of the 1844 Act, it was an easy matter for the unscrupulous to violate the spirit of the legislation through the presentation of fictitious or meaningless balance sheets. Rather than attempting to remedy this defect, the next relevant Act of Parliament, the Joint Stock Companies Act of 1856, abandoned compulsory accounting requirements as well as the audit, which was not to be re-introduced until the Companies Act of 1900. It did however contain a model set of articles including optional accounting and audit clauses, far in advance of the 1844 Act and a standard form of balance sheet which analysed capital, assets and liabilities in substantial detail. In view of the fact that in the previous year, limited liability has been conferred on companies set up by registration through the Joint Stock Companies Act of 1855, it would in retrospect appear strange that such useful detail was only voluntary.

These changes would appear to have been the result of contemporary opinion that matters of accounting should be dealt with by private contract between shareholders and directors. Shareholders as well as creditors had the freedom to choose whether they entered into a relationship with the enterprise. Both parties could look after their own interests by negotiating on accounting and auditing requirements. Voluntary disclosure was backed up by the Punishment of Frauds Act of 1857 which made it a criminal offence for any director officer or manager to falsify the company's books and accounts with intent to defraud any shareholder or creditor or to induce falsely any person to invest, either as a shareholder or creditor. This safety net ensured quality of information rather than the disclosure of information itself.

Despite the focus on investors and creditors it was nevertheless apparent that the affairs of certain types of businesses affected a wider section of society. The advantages of limited liability had not originally been extended to banks and insurance companies. When it was granted to banks it was in return for more stringent control of information through public disclosure. Although this was not enough to prevent the collapse of some banks, it did indicate, according to Edey and Panitpakdi (1956) that ‘prevailing public opinion was prepared to accept some state control for certain types of companies’ (p.367). Regulation was always more detailed for banks and for public utilities and railways, where matters of the public interest tended to be paramount in the minds of the legislature. Edwards, (1989) summarises the period from 1830 to 1890 as one in which accounting methods were governed, by consideration of two user groups (shareholders and creditors) and where financial stability and long-term profit maximisation were a priority.

At the turn of the century, attempts during the Davy Committee (Company Law Amendment Committee of 1895) failed to move financial information into the public domain through compulsory filing of annual balance sheets with the Registrar of Companies, although such attempts must indicate a wish by certain parties to have done so. The 1907 Companies Act made it compulsory to file a balance sheet, which might have been a step forward for users had the Act specified which balance sheet had to be filed, and it was not until 1929 that this particular loophole was dosed, to prevent the same balance sheet being filed each year.

The main incursion of the law into specific matters of accounting during this period tended to be in cases relating to dividends. Prior to 1980, all such law was case and not statute law. Decisions were based upon the tradition that dividends should be payable out of profits rather than capital (French 1977). Shareholders, certainly up to the mid-twentieth century did not accept the modern dividend irrelevancy theories (Miller and Modigliani

1961), and felt they were being defrauded if all profits were not paid to them by way of dividends. The payment of high dividends was the way in which companies attracted new capital. Therefore those industries needing high amounts of capital for expansion or replacement of assets, had to declare high dividends to attract new capital. Thus they tended to make payments that they could not afford, and this was one of the factors contributing to the failure of many 19th century business. Legal judgements which were made in dividend cases tended to reflect a lack of accounting principles.

Decisions of this nature should have been based on some concept of the differences between capital and income but to do this such matters as depreciation would have to have been considered. Although there was a general debate about depreciation towards the end of the century much of this was carried out on a technical level by engineers. Dividend law was based upon a number of disparate cases, with changing attitudes
towards depreciation. The judgement in one dividend case, (Newton v BSA, 1906) both encouraged and reflected the practice of high depreciation by stating that balance sheet values were the minimum values of enterprises, although it was not until 1981 that depreciation became compulsory in law for profit calculation.

This process of under-valuation meant that firms built up secret reserves (Edwards 1989). This practice was considered to be satisfactory in that it encapsulated both prudence and secrecy. It did not hurt either creditors' or shareholders who were seen as having a long term relationship with the enterprise. A committee to review and report on Company Law in 1925 (Greene Committee) endorsed this view. The Institute of Chartered Accountants of England and Wales in their evidence stated 'Secret Reserves or inner reserves are in certain cases desirable and in many cases essential'. The Committee held that in general

British businessmen were honest and if less than full information was disclosed, then this decision was wise and supported by the shareholders. Nevertheless their recommendation included the addition of a profit and loss account, although in the subsequent Companies Act of 1929, this document disclosed little information and was not subject to audit. Additionally by this time it had become common for major companies to operate through a group structure, but the accounting problems associated with consolidations were not addressed. There was for example no need to publish even the names of subsidiaries or disclose amounts of profits made or transferred by them to the holding company.

Towards Accounting Theory

From 1844 to 1929, very little progress would appear to have been made in the development of accounting through government led regulation. But what of accounting theory and practice during this period? The profession had originally formed through the setting up and the grant of a Royal Charter to the Society of Accountants in Edinburgh and the Institute of Accountants and Actuaries in Glasgow between 1853 - 1855. Some twenty years later, the first accountancy journal 'The Accountant' was published. In 1880, the Institute of Chartered Accountants in England and Wales was formed and in 1885 the Society of Incorporated Accountants and Auditors. (The latter Society being then integrated with the English Institute in 1957).

The profession was not operating within any general theory of accounting or even a coherent body of principles. Auditing was their only task, and the first published accounting treatise was on that subject in 1881. This was followed by several books and papers on depreciation but initially the authors tended to be engineers who saw this as a technical rather than an accounting matter. It was not until the 1930's that the first publication in the UK of a book by Garnsey (1931) on consolidated accounts appeared, although this had followed extensive publications on the subject in the United States. Also in the 1920's accounting became a subject taught at Universities usually as part of a commerce degree. Many of the teachers at this time were employed by the Universities on a part-time basis and were also practicing accountants. Gradually as expertise in accounting grew, so did a body of theory, especially at the London School of Economics where a Research Association was set up in the 1930s with a driving force in Ronald Edwards whose subsequent publications anticipated future theory and practice.

The Beginnings of New Problems

Perhaps the main achievement of the 1929 Companies Act was to arrest the decline in reporting practices that had occurred during the 1920s rather than pushing forward the frontiers of accounting. This decline in reporting standards in the early 1920s was caused by the pressure on businesses during this period of economic recession. The use of secret reserves which had partly caused the decline of standards had both its defenders as well as its critics. Secret reserves when transferred to the profit and loss account brought about dividend stability, which gave confidence to the market and facilitated the raising of new capital. A leading accountant at the time D'Arcy Cooper said in his evidence to the Greene Committee that without such undisclosed transfers 'in 1921 you would not have had a company in England which was solvent'. Opposition to secret reserves was not so vociferous, mainly because at this time experience had been limited to the benefits of accounting in this way. However shortly an event was to take place which would encapsulate the problems both of secret reserves and of accounting in general at this time.

Lord Kylsant was the chairman of the Royal Mail Steam Packet Company and Mr Morland, the Company Auditor was a partner in one of the largest and most reputable firms of accountants in the world. As well as being a shipping tycoon, Lord Kylsant was also described as one of the most respected figures in the country. The company which he ran owned one of the largest shipping lines in England, which during the First World War had made large profits, many of which had been secretly transferred to reserves. After the First World War the company had expanded its operations during a time of over-supply in the market and falling prices for both shipping and freight. In the latter 1920's the company was unable to repay a loan of £10m which was guaranteed by the Treasury. Following a government enquiry into the financial affairs, both Lord Kylsant and Mr Morland were charged in 1931 with publishing a false and fraudulent balance sheet.

The profit and loss account showed that, in 1926 the company made a profit of £439,000 whereas the enquiry showed that the company had really incurred a loss of £300,000, the difference being a transfer from reserves. Such practices were not carried out for personal gain. It is suggested that Kylsant took the view that during the downward cycle it was important to retain the shareholder's confidence by paying dividends; hence the need to create profits. Additionally profitability was also exaggerated by companies in the group paying dividends to each other, which were undisclosed in the holding companies accounts (Edwards 1989).

Ultimately both Kylsant and Morland were acquitted of the charge, the main defence being that transfers from reserves were standard practice and that what was to the public, rather a meaningless description of that practice; 'profit after adjustment of taxation reserves' was the description that any professional accountant would have used at the time. This was backed up by leading accountants of the day speaking on behalf of the defence and stating that they would have treated matters in the same way.

The result of the trial was not generally popular. The company had technically been insolvent for some years. In the subsequent reconstruction of the company that occurred, many shareholders lost their investment. There was thus a general antagonism towards accounting practice, which had allowed this to happen. The professional response to this case was mixed. One of the main English bodies, the Society of Incorporated Accountants and Auditors, took the view that the solution was to have detailed laws within which an auditor could then carry out his functions.

The Institute of Chartered Accountants on the other hand, felt that the profession should be free to experiment with new methods and procedures which, if successful could be incorporated into law as required. The fact that the Institute was the dominant partner in the subsequent merger with the Society might account for the modern outlook of those ideas.

It is strange, in retrospect that the law did not change in response to the apparent shortcomings, revealed by the Royal Mail case. Research by Bircher (1988a) has shown that although pressures did exist for an immediate revision to company law, nevertheless there was great opposition to change from the Board of Trade (the forerunner of the

Department of Trade & Industry). Their attitude was that there had only recently been a new Companies Act in 1929 and it was necessary to wait and see what its result would be over time. Additionally the world-wide economic depression of the 1930s followed by the second world war served to move accounting change into an issue of minor importance, and ultimately it was not until 1948 that a new act would be passed which remedied those defects whose origins had been in the previous decades.

Although the government was both prudent in its framing of the 1929 Companies Act and not prepared to change, nevertheless there were significant opponents of that Act. Individual initiatives had arisen within certain large companies whereby attempts were made to improve the level of disclosure. De Paula, who was considered to be a leading expert on auditing, felt that secrecy, far from being a virtue, caused distrust. In 1929 he became chief accountant for Dunlop, and was responsible for increasing the level of their disclosure to such an extent that their balance sheet was highly acclaimed in 1933 for its informative nature. One of the main accounting improvements was in the area of consolidated accounts; after all the use of subsidiaries was one way in which the Royal Mail Steam Packet Company had hidden its results.

Techniques of consolidation had been developed in the USA during the first two decades of the century and therefore would have been known about in the UK. One of the chief advocates of this practice was the economist Sir Josiah Stamp who had become secretary of Nobel Industries (now ICI) and was no doubt influential in their production of consolidated statements from 1922 onwards. Press Comment in the 1920s in the Times, the Economist and the Accountant were in favour of consolidated statements, but the adoption of these had been rejected by the Company Law Amendment Committee of 1925.

During the 1930s the Society of Incorporated Accountants called for the disclosure of subsidiaries' profits and losses on the holding company balance sheet. Attempts by the Society to have the law changed failed, partly because the Board of Trade used examples of good reporting such as Nobel to demonstrate that, if shareholders wanted that sort of detail, it would be produced, returning to the 19th century ideas of accounting being a matter of negotiation between management and shareholders. A strong attack on both the lack of consolidated accounts and the other accounting problems of the day was launched in a well read book, 'Shareholders Money', by a lawyer, Samuels (1933) (many of whose criticisms still apply to contemporary accounting, especially his prophesy that change in accounting will come from among the masses of victimised investors, and the more progressive rank of the accounting profession). Nevertheless there were still many entrenched interests whose positions were based on the current state of the economy Hannah (1983) describes the rationalisation movement in the inter-war years bringing about mergers whose subsequent floatations and calls for capital during this period must have been a breeding ground for the reporting of the highest possible profit figure.

Changes in Practice

The advocates of consolidated accounting were however achieving a slow victory of thought rather than deed. Bircher (1988a) in his research of the adoption of consolidated accounting in the UK describes how by the end of the 1930s, there was a general acceptance of the idea, which was backed up by the Stock Exchange requiring these as a condition of new listings in 1939, although many existing companies were slow to adopt this new practice until they were forced to do so by the 1948 Companies Act.

The Profession Moves (slowly)

Apart from reaction to the Royal Mail Case and the Society's view on consolidated accounts, the professional institutes did little during the 1930's to improve accounting. The Society had formed an unofficial committee to promote the idea of research and the increasing importance of spreading new thought and the evolution of practice, but these were ideas only which did not come to fruition until 1948, when a regular journal "Accounting Research" was published. Surprisingly it was the English Institute of Chartered Accountants, which until then had been the least progressive of the professional bodies, who became involved in the authoritative establishment of accounting principles, although as Zeff observes, more by evolution than by deliberate policy. Increasingly during the 1930's, newly qualified Institute members were taking employment in industrial and commercial concerns. The attitude of the Institute was that such accountants had 'left the profession'. No booklets on guidance statements and technical matters were published and these members in industry were becoming increasingly critical of an Institute which did nothing to serve them.

This led the Institute, in 1942, to attempt to broaden its membership base by the creation of a Taxation and Financial Relations Committee to be composed of both practicing and non-practicing members to consider matters of 'taxation and the financial relationship of the business community with the Inland Revenue and other Government Departments'. The Committee extended its' mandate in a way not foreseen, and applied to (and received from) the General Council of the Institute, permission to prepare drafts of pronouncements on accounting principles. These were non-mandatory but they did express an authoritative statement on accounting, which upgraded existing practice. In all 29 Recommendations on

Accounting Principles were issued between 1942 and 1969.

The 1948 Companies Act

By the end of the war in 1945, the question of changes in the law was addressed by the setting up of a Company Law Amendment Committee (the Cohen Committee). Feelings had built up that more honesty was needed in disclosing financial results, typified perhaps by such statements as the ‘growing public conviction that directorship of a British company is in itself a species of moral trusteeship towards the British Nation’ in the Accountant of 25th October 1941. Keynsian ideas of economic management pointed a way to more state involvement in many areas. A further product of the war was a stronger awareness of the need for social fairness (Bircher 1988a). Insofar as business was concerned, ‘the changing perception of the social accountability of companies meant that accounting could no longer be defended as a private issue’ (Bircher 1988b p.23). The Cohen Committee finally rejected the idea that accounting was a matter concerning directors and shareholders only. They felt that adequate disclosure would get rid of any suggestion of hidden profits which would be to the detriment of consumers and those working in industry. The subsequent Companies Act of 1948 reflected the beginning of a new era of thought and has been described by Edey (1956) as a watershed in British company accounting.

The 1948 Act, as well as making group accounts compulsory, increased the level of disclosure and extended the audit to the profit and loss account. Such was the comprehensive nature of the changes that it would remain as the principle Companies Act for over thirty years with only minor amendments and additions. It came into operation in a period of increasing prosperity following the post war austerity of reconstruction. Problems of accounting tend to manifest themselves during economic downturns and the boom of the 1950s and early 1960s typified by Prime Minister McMillan's "you never had it so good", might have hidden any weaknesses.

The New Round of Problems

Events were to occur however which marked the end of the perception of well-being with company reporting during the mid to late part of the 1960s. Firstly there was the failure of two large companies, the Fire, Auto and Marine Insurance Company and the Investors Overseas Services, both of which were headed by high profile entrepreneurs. Lack of accounting information was not held to blame in either case, but the very nature of the type of companies which affected the lives of many individuals, must have served to weaken public trust in major companies. These failures were followed by three major incidents where accounting practice was a culprit, or at least a principle suspect.

The first of these was the case of Rolls Razer, a household name in the UK as being the first supplier of domestic washing machines on a large scale. The 1963 accounts had shown profits of nearly £400,000 and net assets of £1,600,000 and these accounts had been reported on without qualification by the Company's auditors. Within eight months, the company was in liquidation with net liabilities of £3,200.000. Reporting on the case, Accountancy (the official journal of the Institute of Chartered Accountants, in England and Wales August 1964), claimed that 'the accounts of Rolls Razer did follow modern practice and were more informative than most'. It was not the quantity of information that was lacking, but evidently the quality.

Then in November 1967, the directors of Associated Electrical Industries (AEI), as part of a defence against an unwelcome bid from General Electric Corporation (GEC), forecast profits of £10m for the current year. Subsequently, GEC gained control and figures for the year revealed a loss of £4.5m. A joint report commissioned by the directors from the auditors of both GEC and AEI attributed this to matters 'substantially of fact', £5m and 'matters of judgement', £9.5m. Press comment naturally condemned this, stating that for the investor 'the case is yet another reminder that accounting figures, by their inherent nature, fall into the category of the relatively true rather than the absolutely true' (The Economist August 3rd 1968). The same article also threw some doubt on the efficiency of current professional guidance, 'although the Institutes of Chartered Accountants are constantly issuing progressively more detailed guidelines to their members, it is inevitable that room for differences of opinion will remain'.

The third, of the, major incidents of the1960s illustrates the way in which history repeats itself. In 1969, agreement was reached by Robert Maxwell to sell his company Pergammon Press to a US company, Leasco. Under the terms of this agreement, the price was to be based on a multiple of earnings of Pergammon. When certain key information was not supplied by Maxwell, Leasco called off the deal and a subsequent investigation was carried out by accountants acting for the Board of Trade, which revealed that the stated profit figure of £2.1m for 1968 should really have been £5m if accounting principles has been properly applied. Although the sums involved were smaller than the GEC/AEI case, nevertheless, the high profile of both Maxwell, who was also at that time a Member of Parliament, and of Saul Steinberg of Leasco, brought the matter constant publicity. Once again, the Economist was one of the foremost critics of the profession, attacking it for relying on ‘integrity and commonsense, guided by occasional statements issued by the various professional institutions to back up the information and method of presentation required by the Companies Act’. Even Maxwell commented that ‘accounting is not the exact science that we thought it once to be’, during the subsequent investigation.

The Profession Acts Again

There was however a movement within the profession during this period which was self-critical. Bromwich (1985), describes the formation of an Institute research committee in 1964 as providing some evidence of fresh thinking. There were however staunch defenders of the professional status quo, with bitter public exchanges from Professor Stamp, and Ronald Leach, President of the Institute.

By the time that the Pergammon/Leasco issue had been publicised, there were suggestions in the press that the accountancy professions ‘best practice’ rules should be written into company legislation. The profession itself felt under threat from government intervention, which Bromwich (1992), compares with the experience which had been seen in America where government intervention in matters of accountancy had followed various controversies.

In December of 1969, as an attempt to remedy these problems and prevent such intervention, the English Institute of Chartered Accountants published ‘A Statement of Intent on Accounting Standards’, leading to the creation of the Accounting Standards Steering Committee (ASSC) in January 1970. The purpose of standards was given as:

- Narrowing the areas of difference and variety in practice
- Disclosure of accounting policies
- Disclosure of departures from accounting standards
- Wider exposure for major proposals in standards

The first accounting standard was issued in 1971 and between that year and 1976, the membership of the ASSC was extended to the six major accountancy bodies in the UK, at which time the name changed to the Accounting Standards Committee (ASC). Initially, the committee consisted of 23 members all appointed by their respective professional bodies (of which the English Institute had 12 appointees). Standards that were approved by the Consultative Committee of Accounting Bodies (CCAB) were issued by each professional body to its members. Enforcement was supposed to take the same route. The ASC had no disciplinary or legal authority, gave no interpretation of standards, and there was no appeal against standards. In 1978, a Review of the Standard setting process was made and its conclusions and recommendations published in 1979 as 'Setting Accounting Standards'. The main change resulting from the Review was the wider involvement in standard setting and by the mid 1980s, the constitution of the committee was as follows:-

In practice ,	9
In Private and Public	
Industry and Commerce	6
Users	3
Non-trading Public Sector	2
Academic	1
	21

No doubt much of the thinking behind this change had been brought about by a discussion document published by ASSC in 1975 named ‘The Corporate Report’. This was a general enquiry into the scope and function of accounting reports and identified separate user groups, their decisions and the information that would assist these decisions. The contributors to this report consisted of leading academics, industrialists, politicians and trade-union leaders. Although much of the content was similar to a report published by the American Accounting

Association (AAA) (1966), nevertheless it was, for the UK an extremely progressive document. Its immediate impact was overshadowed by problems of accounting for inflation where both the government and the profession had differing ideas. The long-term effect of the Corporate Report was that it was persuasive in that it formalised the notion that accounting statements did not just affect creditors and investors but that the activities of companies affected other groups in society, thus giving them rights to information. A further review of the standard setting process in 1983 (Review of the Standard Setting Process), brought about little change, and it was not until a major review was commissioned under Sir Ron Dearing in 1987 that significant changes were to be introduced.

Up to this time, although accounting standards had more force than the older ‘Recommendations’, there were still major problems, the main one of which was the enforcement of these standards. There was no direct legal responsibility to comply and it was up to the individual professional body to discipline members who did not adhere. This procedure existed in theory only as Renshall (1992) observed ‘no member was ever disciplined for breaching accounting standards per se during the ASC’s twenty years existence’.

Additionally the relationship of standards with company law was somewhat tenuous. Profit and Loss Accounts and Balance Sheets have had for many years to show a ‘true and fair view’. Courts have tended to interpret this as adherence to Generally Accepted Accounting Practice (GAAP). Since standards are developed by the accounting profession as authoritative statements of practice, adherence to standards should produce the true and fair view. In instances where standards and the law were at odds, then standards could in fact over-ride the law, towards this end.

Apart from the weakness of enforcement of standards, there were two other criticisms of the ASC. Firstly the lack of a conceptual framework of accounting, (although such a project has always had its critics (Macve 1981) had meant that contradiction between individual standards existed and that there was no coordinated approach. Secondly, lack of funding for this as well as for other research into and development of standards might have been an additional cause for failure. The ASC relied upon the accountancy profession for its funding and for voluntary efforts from participants. This often led to accusations of undue influence being wielded by those who contributed. (Day 1977)

The New Authority

A new structure for accounting standard setting was put in place in 1991. Many argued that it represented the last opportunity for the profession to regulate accounting before the task was taken over by the government. A number of large company failures during 1990 and 1991 (Polly Peck, International Leisure Group, Sock Shop), had again brought doubts about the practice of accounting and the function and validity of auditor's reports.

The reconstitution of the standard setting authority represented a move away from the accounting profession's dominance of the process. The ASC had relied upon professional bodies for funding and even their meetings were held in premises owned by those bodies. The current structure reflects both a more independent and task orientated approach to regulation. It consists of a Financial Reporting Council, responsible for raising funds and exercising a general policy and supervisory role. The Accounting Standards Board responsible for formulating and issuing accounting standards, is situated in its own premises and has a full-time Chairman and Technical Director and staff. It has seven other members, drawn from both major companies and the profession, an academic adviser and observers from both the Treasury and the Department of Trade and Industry (DTI). Funding is jointly from the professional accounting bodies, from the DTI from the Bank of England and the Stock Exchange. The Board issues standards in its own right rather than via the individual professional bodies. Although there originally was pressure for legal backing for standards (as is the case in Australia), the government did not want to give this additional authority, preferring self-regulation to be practiced by the accounting profession (Bromwich 1992).

Despite not receiving this backing, the creation of an additional body, the Review Panel, under the Financial Reporting Council, means that enforcement of standards can take place. Cases of non-adherence to standards are reported to the Review Panel who may then take action. Initially such action consists of a request for the company involved to explain its' viewpoint. If the Panel is then not satisfied, it can request that the financial statements be changed, an expensive process as these will have already been printed and circulated. As a final resort, Court Action could be taken against the company not complying, with the directors being responsible for costs. In the view of the fact that any such action would be decided upon accounting principles, it would appear likely that the outcome would be unfavourable for the defendant company. Investigations by the Review Panel of major companies have resulted in assurances that breaches and misleading or obscure accounting practices will not be repeated or in forcing the company to restate certain information.

The new standard setting structure does mark a movement towards more State backing for Standards and as Bromwich (1992) describes it, a move towards the United States model, albeit without the creation of a Securities and Exchange Commission.

Conclusion

The UK regulatory framework has changed significantly since the 1844 Companies Act marked the first formal control over accounting. The present situation reflects some one hundred and fifty years of thought, practice and events. This generalisation could be made more specific by the examination of individual influences on accounting, all of which are significant, but none of which uniquely explain UK accounting regulation.

Nobes, Parker (1998) identify reasons for the variation in accounting practice especially between the UK and other EC member states.

The influences that he identified for these variations are also a useful structure for explaining the current state of UK regulation were:-

- Legal Systems
- Providers of Finance
- Taxation
- Inflation Theory
- Accidents
- External Environment and Culture

In contrast to the majority of other European countries which have a Roman system of law, accompanied by detailed provisions or commercial codes, the UK has a commercial legal system relying on a limited amount of statute law. Dividend cases are an example of the way in which much of the legal background to accounting was established; courts had to form their own opinions of such elusive concepts of capital and income on a case by case basis. Additionally, it is worthwhile noting that in the Royal Mail case, Lord Klysant was not prosecuted under company law, but under criminal law relating to fraud. However since the 1981 Companies Act, which incorporated the 4th Directive of the EC, the UK is thought to be moving towards a more codified system.

For many European countries, traditionally the providers of equity finance have not tended to be individual shareholders. Large amounts of share capital is owned and controlled by the banks (especially Germany), the State (France and Italy) and families (France), although privatisation of major industries has tended to change these ownership structures. In the UK there is a predominance of private and institutional shareholders.

Separation of ownership and control has always highlighted the need for good reporting practice. Where large shareholdings dominate companies, the need for accounting information is marginalised. In other situations, financial statements are the main information source for shareholders. Few demands were made for more or better information in the UK up to the 1930s because of the way in which secrecy was considered a virtue and directors of companies were considered honest and in all cases working for the interests of their shareholders. This faith was backed up by the use of an annual audit, the origins of which dates back to the first Companies Act of 1844 (in contrast to Germany, where compulsory audits did not take place for another 120 years).

Taxation in many European countries may be considered a driving force in the development of accounting. Depreciation based on tax laws is relatively common. The UK on the other hand has an older tradition of company accounting; rules were developed both before and apart from taxation rules, the first profits tax not being introduced until 1937. Rather than the contents of published accounts being laid down by tax authorities, they use these accounts only as a starting point for making the necessary adjustments before calculating tax charges.

The need for audit is responsible for the setting up and growth of the UK accountancy profession. Entering the scene at a time of little legal regulation or guidance, they were forced to develop their own methods of operating. Gradually this led to formation of generally accepted accounting principles which were the forerunners of accounting standards. A strong and persuasive profession with a history of developing its own principles meant that an expert body existed outside of government. Technical expertise tends to render any group independent of government control (Self 1985). The UK accountancy profession dates back to 1854, compared with France (1942) and Germany (1932). Not only in history, but also numerically is the UK profession is larger. In 1997 in the UK and Ireland there were 189,000 qualified members of accounting bodies, compared with France, 15,000 and Germany 8,000. The power of the UK profession is a considerable factor in the use of self-regulation as opposed to government regulation of accounting details.

Inflation has had a significant effect on the development of accounting in the UK. During the 1970's, it overshadowed other debates and brought the profession into conflict with the government. The conceptual gap between accounts based on historical cost and those using a system of current values has been accentuated by periods of high inflation and its legacy may in part be the non-acceptance of the ASB's Statement of Principles which has retained its Exposure Draft status for many years.

The UK has a tradition of accounting theory, although the subject only became an academic discipline at UK Universities in the 1920s. Theories of accounting had been developed from the 17th century onwards with works such as Hamilton's treatise linking accountancy and economic theory. Despite the low level of theorising by the profession, nevertheless, occasional incursions were made into the areas of research. As the academic study of accounting in its own right became more extensive so research also became more prevalent. Without theoretical underpinnings, it is difficult to envisage how the development of certain concepts fundamental to accounting standards, would have come into existence.

Accidents is a general category for these events which lead to change. Certainly the crisis in accounting in the late 1960s demonstrated by the company failures and scandals described earlier in this paper were a contributing cause of the creation of the first standard setting authority. The company failures of the late 1980s certainly gave impetus to the movement for reform which culminated in the creation of the Accounting Standards Board. Britain's membership of the EC is within the 'accident' category as far as accounting is concerned. Under the provisions of the 4th Directive (incorporated into the 1981 Companies Act), for the first time the format of profit and loss accounts and balance sheet became mandatory and some asset valuation rules were included. The reason for membership of the EEC was for economic benefits; accounting change in this context was an accident.

Changes in the society in which accounting has been practiced is a complex area and one which can only be covered superficially in this analysis. External environment and culture reflect the Hopwoodian ideas on contextualisation. The 19th century was a period of laissez-faire within the economy. This meant that business could compete without being handicapped by detailed rules. Secrecy in commercial dealings was considered a necessary characteristic. Although companies were nominally accountable to their shareholders, attitudes towards them were paternalistic. It was considered that as long as shareholders were provided with satisfactory dividends and trusted the Directors then they needed little more information. This attitude, which continued into the early decades of the 20th century was captured by a description by Mr Justice Wright, summing up in the Kylsant trial, of shareholders who 'like sheep look up when they are not fed'. No other user groups were considered to have any interest in the accounts of Companies. A study of information disclosure to employees by Day (1988) shows that from the early part of this century, information given to employees was only that relevant to profit-sharing schemes, and although calls were made for more disclosure, it was not until the post-war period that this occurred, partly because of ideas of ‘social fairness’ (Bircher 1988a) and partly in the interests of increasing productivity. Reporting to employers reached ‘its ‘peak in the 1970s with laws such as the Employment Protection Act of 1975’ forcing disclosure of relevant information to trade unions.

The improvement in the rights of workers was not an isolated phenomena. Other social changes were occurring which manifested themselves in the 1960s. Events such as the student uprising in Paris in 1968 were symptomatic of attitude changes throughout Europe. In the UK the presence of restrictive legislation, eg the Official Secrets Act were queried; people wanted more freedom from authority, both moral and legal. No longer could companies be viewed as operating in a vacuum; they were part of society and had to therefore be accountable to that society. As financial reporting is the way in which a company systematically gives information to society, this was felt to be the way towards achieving that accountability. This was recognised by The Corporate Report’ (1975) and marked the end of the view that accounting was simply a private matter between the company and the shareholders.

The government has rarely been active in the area of accounting regulation. The laissez-faire principles of the 18th century precluded too many detailed rules; accounting was a matter of contract between investors and businesses. Increasing government control of the economy during the Second World War created the environment for recognising those social demands, which were incorporated into the 1948 Companies Act. Apart from a brief period during the 1960s there has never been any formal economic planning within the UK and it would appear that the government is not generally a user of company accounting information apart from in collection of company statistics; its' interest in proposed standards arises only where these may be in conflict with economic policy (Day 1991).

It would be presumptuous if not implausible to attempt in this paper to describe the causal links between any of these influences and accounting regulations. Nevertheless if they are to be explored, the validity of such work can be justified. If the causes of accounting change are understood, then the process can be controlled; we could learn how to turn societal demands into new regulations that would lead to more useful information with a resulting increase in social welfare. Understanding the causes of change and how the demands of society are articulated (and whether they are met), is an important task, but one that cannot be carried out at a single point in time. The development of accounting is a process, which evolves over time, and therefore the role of history is central to any attempt to understand that process.

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