A Golden Age in setting national accounting standards: The UK's Accounting Standards Board, 1990-2000

Geoff Meeks

Introduction[1]

In the late 1980's financial accounting in Britain was in disarray. The authority of the industry's standard-setters had been drastically compromised when their rules for inflation accounting were first ignored by many firms and then abandoned. 'Big Bang' had brought more aggressive ways of working in the financial sector, and this included circumventing accounting rules to flatter a company's accounts and mislead investors. A best-selling book (Griffiths 1986) had the sub-title, 'How to make your profits what you want them to be'. The users of accounts were losing confidence in the accounts prepared by businesses; accountants feared a loss of trust in their profession; and there were calls for government to replace the accountants' self-regulation with a tough regulatory regime close to the American model. In addition, rapid change in the financial industry was generating complex new financial schemes for which existing accounting standards were inadequate.

A committee chaired by the ingenious administrator Ron Dearing proposed a new regime with more authority and more resources: the Accounting Standards Board (ASB). Neither purely private - self-regulation - nor arm's length public, it was designed to secure access to the technical expertise of the profession and the support from practitioners needed to achieve compliance – but without suffering regulatory capture. Inevitably it faced resistance from vested interests - investment bankers, lawyers and executives used to manipulating the accounts. It was not clear in 1990 that the Board would succeed where its predecessors had been thwarted.

In 1990, according to The Times newspaper, UK 'company accounts were a laughing stock'. By 1997, for example, the former chairman of the US standard-setter, FASB, wrote that 'there are great improvements to the accounting for business combinations in the UK, and they represent a model that the US board should emulate in its own project (Beresford 1997); while in 1999 Financial Director wrote that the ASB had been 'universally hailed as a success'.

A new book (Tweedie, Cook and Whittington 2023, henceforth TCW) tells via a discussion between three members of the Board the story of these reforms: the problems the standard-setters faced, both technical and political, the solutions they developed, and the durability of their work. This paper draws on the book to highlight, with illustrations, some representative contributions by ASB to financial reporting – both shrewd firefighting within the inherited accounting model, and more fundamental innovations in the model. To convey the scale of the contributions, it outlines the resistance the ASB had to overcome in securing their reforms – for example, from finance directors over goodwill, from some parts of the accounting profession nostalgic for the permissive 1980s, from libertarians hostile to any intervention in markets, from lawyers insistent on compliance with the letter of the law rather than its spirit, from actuaries over the valuation of pension liabilities, or from government over off balance sheet financing. The paper also touches on a topic of interest beyond accounting – how to make work an

[1] Another version of this paper is included as chapter 10 in Tweedie, Cook and Whittington (2023).

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innovative model of 'self-regulation with statutory backing'[2], something in between the self-regulation of the Accounting Standards Committee (ASC), which preceded the ASB, and had in important respects failed, and pure state, top-down regulation, which some proposed at the time.

Because the account in the book is provided by members of the Board, and because the author of this paper has long been a friend of two of them – it is clear that the book and this paper derived from it are not independent history, but provide (well-informed) subjective perspectives and recollections which may not be shared by other participants in these events. The potential bias is, however, mitigated in this paper by heavy reliance on independent contemporaneous assessments of the ASB's activities. This was a golden age for accounting commentary, with very high quality discussion of accounting problems and reforms by broadsheet journalists, in professional magazines, and in books. These contemporary sources have a further advantage: it's sometimes difficult just from today's vantage point to recognize the full extent of ASB's contributions. Some abuses of accounting prominent at the time were so effectively curbed by the ASB that they have fallen out of discussion in modern accounting. Reformed practices which we now take for granted – treat as part of the natural order - were fiercely resisted at the time.

Firefighting

Tweedie and Whittington published in 1990 a lengthy article in an academic journal (written before they joined the ASB), giving their account of the principal weaknesses in company accounts at that time. At the birth of the ASB, Whittington and Cook were invited by the British professional accounting institutes ICAS and ICAEW, to outline key challenges facing the Board. Their diagnoses corresponded quite closely with that emphasised by the highly respected analyst Terry Smith in his best-selling 1992 book for investors, Accounting for Growth. Smith (1992) illustrated what was, in his words, 'wrong with UK accounting' when the ASB was founded. He suggested the scale of misinformation in the accounts. He gave 'examples of companies going bust in this recession which reported "profits" in their last results and announcements and accounts…' And he went on '…much of the apparent growth in profits which had occurred in the 1980s was the result of accounting sleight of hand rather than genuine economic growth…'(p3-4).

The deceitful devices enumerated by Smith were compliant with the law and with the prevailing, pre-ASB, standards. As Griffiths' early (1986) expose of creative accounting comments: 'the hallmark of [effective] creative accounting is that it does not involve fraud'. Such creative accounting is the analogue of tax avoidance, as contrasted with tax evasion. It attracts sophisticated professionals who frame the activity so that it conforms with the letter (but defies the spirit) of the rules.

The materiality of the challenge presented by creative accounting to the functioning of financial markets is indicated by the size of the markets which were being misinformed. New issues (shares and loan stocks) by UK industrial and commercial companies were running at around 15 billion pounds a year in the nineties; the secondary market in existing shares was valued at around a trillion pounds; and the M&A market reached 30 billion pounds in some years in that decade (1990s prices; Meeks and Meeks 2002).

[2] The description by Sir Sydney Lipworth QC, Chairman of the FRC after Dearing, in World Accounting Report (1995), Standard-setters Conference, December/January 1995.

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Tweedie explains in chapter 2 of TCW that 'The first standards were really anti-abuse and attacking the schemes.' Chapters 3, 4 and 5 of TCW review these early standards. By his second edition in 1996, Smith was able to write:

'The foundation of the ASB under Sir David Tweedie was a recognition that there was a great deal wrong with UK accounting. Tweedie has set about correcting this with an almost evangelical zeal. And he tells good jokes. It does not do full justice to his achievements simply to list its published standards. … FRS3 basically outlawed extraordinary items and thereby rendered Chapter 7 in the first edition redundant…all of the techniques described in the old chapters [in Smith's1992 book] on Off Balance Sheet Finance and Convertibles With Put Options and AMPs have effectively been dealt with by FRS2, FRS4 and FRS5.

…There is little doubt that the ASB has achieved a great deal in making UK accounting more rigorous.'(pp.9-11)

And elsewhere in the book Smith outlines other achievements in those early years. In the balance sheet these included providing robust definitions of assets and liabilities, and bringing previously hidden debt onto the balance sheet. In reporting of the accounting period's flows, the information published was transformed – by forcing full disclosure of movements in cash in the new cash flow statement, making transparent other gains and losses in the new STRGL, and disaggregating continuing and discontinued activities in the P&L.

Looking back at the firefighting programme in 1997, Sergeant wrote

'At the start of the decade, when the powerless old Accounting Standards Committee was wound up, things were very different. Company accounts were a laughing stock and the profession was at bay. Smart finance directors and their advisers had found the bean-counter's stone: cookbooks on how to turn losses into profits and liabilities into assets. Empires were built by creative accounting allowed by loose rules, lax enforcement and weak-minded auditors.'

'…FRS10 virtually completes the reform of accounting rules set in train to end the scandals of the last boom and slump. It has been a rare success in state-sponsored, self-led regulation.'

Bruce (1996b) was similarly appreciative of the reform programme:

'The Tweedie revolution has stopped much of the old 1980s methods of finding a way of disguising management failure.'[3]

'…the obvious loopholes have been closed; and, secondly, the rules have focused on forcing people to look harder at what the figures mean.'

Not everyone was so enthusiastic to see so many loopholes closed. For example, the investment bankers who (chapter 2 of TCW) taunted Tweedie - then still an audit partner - over his powerlessness to prevent

[3] Some of the commentary quoted below appears to identify the achievements of ASB as those of Tweedie alone: for example'…many see Sir David as the man who rescued the UK from the cancer of creative accounting' (Financial Director (1999)). This is not how Tweedie sees it: he emphasizes the collective effort of the ASB team – Cook, Whittington and other Board members; and very able and committed staff.

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misleading accounting, will have regretted the loss of lucrative creative accounting schemes; likewise the lawyers who deployed their wisdom and skills to make the schemes safe from challenge.

Innovation

Purchased goodwill

The Board faced a pressing need to reform accounting for purchased goodwill. But such reform presented both technical and political challenges. The scale of goodwill was rising fast. The value of UK public company M&A in 1989 was equivalent to about 20% of GDP, and 17 times its value in 1980 (Smith 1992). In some cases the major portion of the purchase consideration was allocated to goodwill. It was the balancing item in many of the creative accounting schemes involved with acquisitions, enabling some firms to 'choose their profit' after acquisitions.

There was a wide range of treatments of goodwill in different jurisdictions. An ASB Discussion Paper in 1993 listed no fewer than six possible ways of accounting for it. The arrangements inherited from the ASC allowed three of them: recognition plus amortization; or recognition plus write-off against reserves; or merger accounting – completely avoiding recognition. 95% opted to write off against reserves, which was encouraged by the ASC (yet not allowed in other jurisdictions). The different treatments could yield very dissimilar balance sheets and profit figures.

When the ASB began work, it was widely accepted that accounting for goodwill needed reform. The ASC had issued Exposure Draft 47, suggesting major change. But the draft provoked more responses than any other since the notorious one for current cost accounting; 80% of corporates objected to the proposals.

It was a hot potato. And the ASB initially put it in the freezer, to be brought out when the Board had established its reputation and authority by tackling urgent, but more tractable, firefighting needs.

Work on goodwill began in earnest with the 1993 Discussion Paper. There followed an extraordinary sustained campaign to reach an understanding – especially with the corporate preparers, who had been so solidly opposed to the ASC's earlier proposals. The campaign included a lengthy public hearing and widespread efforts – formal and informal - to consult and persuade. Tweedie's diary for just 1996 includes no fewer than 278 meetings with, or speeches to outside bodies and individuals[4]. Cook and Whittington, as well as other members of the ASB team also went out to listen and persuade. In addition, the campaign included field-testing of the major proposed innovations by seven major companies who were big acquirers.

As the proposals took shape, the FT's Lex column (1995) commented:

'The Accounting Standards Board's proposals on accounting for goodwill are a triumph of diplomacy as well as intellectual ingenuity.

[4] Other standard-setters: 47; press: 61; institutes: 47; auditors: 53; industry: 37; academics: 27; analysts: 13. These were over and above all the internal meetings at ASB.

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’…Amazingly, given the passions which goodwill accounting provokes, the proposals are likely to meet with widespread approval. This is despite the fact that companies’ favoured way of dealing with the substance – writing it off against reserves – is set to be outlawed.’

‘…If the proposals are adopted, the quality of accounts will be doubly improved. Goodwill will be visible in the accounts, not written off and forgotten. Furthermore, the tests on the value of goodwill seem rigorous and yet not unduly complicated, and will prove a useful discipline for managers.’

The exhausting engagement with preparers and other interest groups worked: whereas the ASC’s ED47 had met 80% <u>objections</u> from the corporates, the 1995 working paper attracted <u>support</u> from 59% of them.

When the new rules were introduced, FT’s Lex (1997) went on:

‘Investors should welcome the Accounting Standards Board (ASB) ruling on goodwill. No longer able to write off goodwill on acquisitions … [firms] will finally have to acknowledge it on the balance sheet as capital employed. Writing goodwill off against reserves was unsatisfactory and out of line with international practice. It overstated returns on investments and gave the erroneous impression that the buyer’s net worth had been depleted, rendering the balance sheet meaningless.

With managers now accountable for all the costs of buying a business, it will be easier to spot those who overpay. Furthermore, the requirement to amortise should help speed the move away from justifying deals in terms of earnings per share enhancement. The new standard should facilitate scrutiny of whether acquisitions really create value for shareholders.

The ASB’s innovation – allowing companies to avoid amortising goodwill and other intangible assets altogether if they can prove in an annual impairment review that is has not been dissipated - could well become the international standard. Clearly some assets, such as the Coca Cola or Johnny Walker brands, have extremely long economic lives, and should not be amortised over the normal 20 years.’[5]

And there was admiration from experts abroad: for example – as noted above - the former chairman of the US Financial Accounting Standards Board (FASB) wrote:

‘These are great improvements to the accounting for business combinations in the UK, and they represent a model that the US board should emulate in its own project.

…The US board often leads the world on financial reporting improvements. In this case, however, I believe the board should import the improvements developed in the UK.’

(Beresford 1997)

FASB did indeed propose new rules similar in important respects to those initiated by ASB. They proposed in 1999 that goodwill be routinely recognised in the balance sheet and amortised through the income statement. The subsequent hostile lobbying by business, whose objections were taken up by

[5] While the ASB was ready to challenge the status quo with innovations in many aspects of M&A accounting, its success in securing consent and compliance owed something to a readiness to compromise when an option they preferred was too great a change for the constituency. The authors mention in chapter 7 their preference for ’fresh start’ accounting with business combinations, but their awareness that it was a ‘non-starter’ with their constituency, and they did not waste political capital on pursuing it.

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Congress, was so intense that FASB abandoned the proposal and instead introduced compulsory recognition plus discretionary impairment (Beresford 2001, Zeff 2002).

Why was there such intense opposition to the amortization of goodwill? With goodwill recognised in the balance sheet, analysts could if they wished readily impute an amortization charge to adjust reported earnings; so amortization would seem to be irrelevant to valuation. What, then, motivated the angst of the opponents of amortization, one senior executive arguing in Congress that FASB's proposed standard would 'stifle technology development, impede capital formation and slow job creation'[6]?

One possible explanation may be found in senior executives' remuneration contracts. High powered incentive schemes have become more widespread in recent decades. The increased power is reflected in evidence on the ratio of chief executive pay to that of the typical worker in a population of US companies reported by the Financial Times (2022): from 20-to-1 in 1965 to 399-to-1 in 2021.

Earnings per share (EPS), the 'all important'[7] metric followed by investors has been an important driver of these schemes (along with greater size – rapidly achieved through M&A)[8]. Typically EPS was written on net income (after goodwill write-offs (Murphy 1999)). And Chapter 6 above gives an illustration of the potential effect of amortisation on this metric: BP's reported annual earnings would have been depressed by as much as 37% if it had been required to amortise the putative goodwill associated with its combination with Amoco (Li 2007)

Relevant to the link between pay and performance, a major statistical study by Harford and Li (2007) concluded that 'Even in mergers where bidding shareholders are worse off, bidding CEOs are better off three quarters of the time.' And the bidding shareholders have frequently been 'worse off': a McKinsey report (2010) concluded that 'Anyone who has researched merger success rates knows that roughly 70% fail'; and peer-reviewed academic studies reported by Meeks and Meeks (2022) have mostly found no post-merger operating gains on average.

In these circumstances it is not surprising that executives might resist having reported profit diminished explicitly – via amortisation – the diminution of the nebulous, often wasting, asset goodwill purchased with shareholders' funds. There is then a stewardship challenge for accounting in relation to the $4trillion[9] or so spent globally on M&A in a typical year[10].

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[6] Dennis Powell, quoted in Beresford (2001).

[7] Gryta and Mann (2020) in their study of the then biggest corporation in the world, GE, which made some 1700 acquisitions over 36 years, before disintegrating (Dissanaike et al 2022), and which, in the words of the director of the Securities and Exchange Commission's enforcement division, 'bent the accounting rules beyond the breaking point' (Edgecliffe-Johnson et al 2021).

[8] See Meeks and Meeks (2022, chapter 2) for a detailed discussion of incentives for senior executives.

[9] See Meeks and Meeks (2022, chapter 1) for a detailed discussion of statistics on the scale and outcome of M&A.

[10] As well as protecting executives from scrutiny of their spending on goodwill, forbidding amortization distorts investment decisions. Meeks and Meeks (2022) ask: under the regime secured by the business lobbyists, why would the CEO of a tech firm with funds to create intangibles spend years depressing reported earnings by generating the intangibles internally when she could just buy them 'ready-made' in an acquisition, with no hit [from amortization] to reported profit?(p.87).

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Defenders of the - no amortization - resolution forced on FASB might argue that the diminution of purchased goodwill was better represented by estimated impairment than by the mechanical device of amortisation. But a problem with this is that anyway, and especially in the FASB version, impairment is vulnerable to manipulation. The FASB version did not incorporate the monitoring safeguards included in the ASB's 'hybrid' or 'twin instrument' version which combines amortisation with impairment.[11] Comiskey and Mulford (2010), Ramanna and Watts (2012), and KPMG (2014) report that in practice, impairment estimates relied excessively on managers' judgements concerning valuation models, cash flow forecasts and discount rates; that those assumptions were inconsistent across firms; that distinguishing internally generated goodwill from purchased goodwill was challenging; and that the subjectivity is far greater for this than for most other asset classes. Unless a firm was obviously in serious distress it was generally fairly easy for managers to avoid recognising the depletion of goodwill in an impairment charge.

FASB has not been blind to this evidence on the shortcomings of their standard. And, for one sector - private companies - FASB reverted to its original (ASB-like) position in 2014, allowing private companies to amortise goodwill (FASB 2014). As most discussion of standard-setting has focussed on publicly listed companies, this may seem trivial – but it is perhaps more significant in view of the attrition of companies on the US and UK stock exchanges and the rising share of M&A conducted by private equity[12].

Then, in 2020, FASB seemed to be aiming for a similar change for companies on the stock exchange. Lugo (2020) reported that 'FASB tentatively said it would require public companies to amortize goodwill over a 10-year period on a straight-line basis only, without exception'.

Similarly, IASB (2020) addressed the problem and invited views on the possibility of restoring amortisation, noting that Board members were divided concerning its merits[13].

But then there has followed a development which feels increasingly like Groundhog Day – a re-run of the experience around the millenium. Lugo reported (2022) that

'the board [FASB] had leaned toward requiring that entities apply an impairment with amortization model, where an entity would amortize goodwill over a 10-year default period that would be limited to a 25-year cap'.

But 'on June 15, 2022, [FASB] unanimously voted to drop its project on identifiable intangible assets and the subsequent accounting of goodwill…The decision came as a huge surprise to market watchers'.

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[11] Amel-Zadeh et al (2020) report statistical analysis which turns out supportive to the ASB version.
[12] Tepper and Hearn (2019) note for the US that between 1996 and 2016 the number of listed stocks in the US fell by about half. Meeks and Whittington (2021) also report a rapid attrition of companies on the UK exchanges. Private equity is accounting for a high and rising proportion of M&A activity, with its frequent private purchases and sales of companies (KKR's private equity funds alone currently employ over 800,000 people (Gara and Vandevelde 2021)).
[13] My response to that invitation – strongly in support of amortization – is recorded in Meeks (2020).

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Had the executives and their lobbyists been at work again, as two decades earlier - anxious that perceptions of their mergers, and their compensation packages, might suffer if amortization was demanded?

At the time of writing it seems likely that IASB will – as two decades ago – opt for convergence with the USA, and follow FASB.

Meanwhile – Groundhog Day again - the UK is again resisting the retreat. The UK Endorsement Board, which 'influences, endorses and adopts new or amended international accounting standards issued by the International Accounting Standards Board (IASB) for use by UK companies', has expressed itself in favour of a 'hybrid', 'twin instrument' model similar to the ASB's, combining amortization with impairment (UKEB 2022).

Pensions

A similar, patient stepwise approach to a controversial and innovative standard is evident also in the development of the pensions standard, FRS17, which replaced the actuarial approach of the ASC's SSAP24 with a radically different fair value, or balance sheet approach. FRS17 built on the foundations installed in the ASB's earlier standards: bringing all the assets and liabilities on balance sheet (FRS5), showing the different components of income (FRS3) and 'telling it as it is' with liabilities (FRS4). Moreover, FRS17's general approach to valuing the pension fund asset/liability had already secured approval in FRS7 when valuing an acquiree. However, the new standard promised to overturn the approach favoured and implemented by the actuarial profession. When the first Discussion Paper containing the proposal was issued, <u>only one</u> actuary <u>supported</u> it. After a programme of consultation and persuasion, <u>only one actuary</u> <u>did not support</u> the second Discussion Paper. In Tweedie's words, 'there was a complete swing'.

Tweedie persuaded the G4 too, at least to the extent that they wrote 'we think the way the ASB is going about this is probably the right way to go in the future'. UK companies too came to accept and support it, and lobbied (successfully) for permission to retain the ASB model when they became subject to the IASB regime. Finally, years later, in Tweedie's last month as Chair of the IASB, that body adopted the ASB model[14].

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[14] This is the only ASB standard about which I have reservations –not about the underlying principles or recognition, but about measurement. Even those sympathetic to the efficient market hypothesis recognize the fragility of share prices on any particular day. Fischer Black (1986), President of the American Finance Association, wrote:

> [We] might define an efficient market as one in which price is within a factor of 2 of value, i.e., the price is more than half of value and less than twice value. The factor of 2 is arbitrary, of course. Intuitively, though, it seems reasonable to me, in the light of sources of uncertainty about value and the strength of the forces tending to cause price to return to value. By this definition, I think almost all markets are efficient almost all of the time. "Almost all" means at least 90 per cent.

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‘Blue on blue’ attacks: opposition from within the accounting profession

The last section traced the conversion of finance directors from outright hostility to losing their favoured accounting treatment of goodwill to supporting just that – a ‘triumph of diplomacy as well as intellectual ingenuity’. Likewise, consultation and persuasion (along with some influential support from within the profession) achieved a volte-face by actuaries, in favour of the Board’s innovative accounting.

But through much of the 1990s the ASB faced sustained public attacks from one of the Big Six accounting firms, Ernst & Young (EY). In some respects, EY were important contributors to the reform programme. Their senior partner at the time, Elwyn Eilledge, was a distinguished and enthusiastic member of the Board in its early years. The Senior Technical Partner, Ron Paterson, regularly drew attention to anomalies in accounting practice. And the firm’s substantial review of practice, UKGAAP, is a highly respected standard reference work. However in important respects, EY was not aligned with the ASB and with the other major accounting firms.

Hostility to the ASB mission was already evident before the Board had started work: EY attacked Terry Smith’s acclaimed critique of misleading accounting practices. Smith recounted in the second edition of that book that EY ‘were the only firm which had gone on record at the time of publication to condemn the book as “dangerous and irresponsible”’. (Smith 1996, p.4)

Subsequently EY produced a string of hostile articles in the professional magazines, and an extended critique mailed to the finance directors of all major companies.

Their objections seem to include:

1.The ASB is held to accord primacy of the balance sheet over the profit and loss account; but the latter, reporting the periodic flows, is thought more important to users of the accounts than the snapshot of assets and liabilities on one day.

2.The ASB is aiming to reintroduce current cost accounting by stealth – by requiring current values for some balance sheet variables.

3. The ASB is deaf to arguments which do not coincide with their agenda.

In relation to objection 1, the ASB actually gave very high priority to reporting flows, not only by making the P&L more reliable by curbing creative accounting, but also by substantially expanding the information available on flows - through the new cash flow statement and the statement of recognized

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Nobel Laureate Shiller (2015) has assembled compelling evidence that the fluctuations in stock market prices are indeed much greater than is warranted by the variation in subsequent real dividends which they would reflect in a market which was fundamentally valuation efficient.

I find single day observations of such prices an uncomfortable basis for measurement of pension fund assets in relation to assessing the progress of transactions (pension contracts) lasting up to 60 years.

Then the use of the AA corporate bond rate to discount liabilities is troublesome when that rate is determined not by free market forces but by central bank intervention in pursuit of macroeconomic objectives. When the Bank of England drove down the rate by two percentage points in 2010, the present value of a pension liability 60 years ahead increased three-fold overnight (Meeks, 2017).

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gains and losses. These modifications and additions by the ASB were partly prompted by the question Terry Smith said he encountered from investors: 'XYZ company went bust last week, but it was making profits. How can that happen?'

Then in relation to the attention given by the ASB to the balance sheet, TCW explain that this was prompted by the previously loose definitions of assets and liabilities, which made comparison between companies more difficult, and, because of their implications for measuring income, created opportunities (then being actively exploited) for distortionary creative accounting. As Dechow et al (2011) observed: '…the more assets on the balance sheet that are subject to changes in assumptions and forecasts, the greater the manager's flexibility to manage short-term earnings.' Manipulation of the balance sheet undermined the reliability of the P&L.

As for concern 2, the ASB had made it clear that they had no intention to reintroduce current cost accounting. But some components of the balance sheet such as the burgeoning derivatives, did not have a historic 'cost'; and market values for some components were of particular value to users.

Then concern 3 – deafness to disagreement – is hard to reconcile with the remarkable efforts described above, which were sustained over several years, to find a robust treatment of goodwill acceptable to preparers and users, or to reach agreement on the major change in accounting for pensions.

Yet contemporaneous comments show how heated the debate became.

On the one side, EY sent a critique of the ASB's discussion draft on the future of company reporting to the media and the biggest 350 companies in Britain. They described the ASB framework as 'pernicious', 'open to abuse' and 'fundamentally misguided'. It 'strives for an accounting model that we do not believe is desirable, based on principles we do not believe to be workable.' (European Accountant (1996)).

But all five of the other Big Six firms took a different view. For example, in a letter to the Financial Times, John Roques, Senior Partner and Chief Executive, Deloitte and Touche, wrote:

'In the interests of good financial reporting, the false picture portrayed by the Ernst and Young document criticizing the Accounting Standards Board cannot go unchallenged.

Despite its disclaimers, the document amounts to an attack on the very existence of the ASB itself. I strongly deplore the false implication that the ASB is out of touch and does not reflect the needs of users.

On the contrary, it is to the ASB's great credit that the accounting standards it has produced so far (which are based on the principles contained in its draft statement of principles[decried by EY]) have done much to raise the quality of financial reporting. Do we really want to return to the accounting of the late 1980s?

…Although I do not always agree with the ASB, I strongly support the open and reasoned way it approaches its tasks and I cannot allow its substantial achievements to be undone by an unthinking hankering after yesterday's accounting'…

Coopers and Lybrand, KPMG, Price Waterhouse and Arthur Andersen issued comments along similar lines.

The broadsheet newspapers also responded vigorously.

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Robert Bruce of The Times first quoted the EY Senior Partner Nick Land's foreword to the EY booklet, Time to Decide:

'Some of its [the ASB's] proposals are theoretical to the point that they are scarcely comprehensible by most accountants and other businessmen. Accounting, traditionally the language of business, is at risk of being taken over by the rhetoric of theorists.'

And then Bruce offered his own interpretation:

'It is possible, perhaps, to read between the lines here. Company directors are conservative and dislike new rules. Finance directors find it painful to confront them with Tweedie's new realities. There is commercial advantage in being an accounting firm that seems to support the harassed company director against the bogey of radical accounting theorists.'(Bruce 1996a)

The Financial Times' Jim Kelly (1996) also sensed ulterior motives on EY's part:

'There are two sharply different explanations of the firm's policy. It either springs from a series of genuine and heartfelt differences of opinion with the ASB or is a marketing stance designed to set it apart amid the uniformity of the Big Six market.'

And The Independent (1996) was more forthright still:

'The problem [for EY] is that just about everybody else sees the attack as opportunistic marketing that threatens to undo the progress that Sir David and his colleagues have made since the late 1980s.'

Then the magisterial FT Leader (1996) issued a strong rebuke to EY:

'The tone of the [EY] paper is harsher than is warranted. It is unfair to accuse the board of unworldliness; Sir David Tweedie, its chairman, has made clear that its "preference" for a change could not be implemented without widespread support. It is also melodramatic to accuse the board of stealth, when its statement was a highly public attempt to stimulate debate. The board makes clear that it wants evolution not revolution.'

Relations with the legal profession

In a discussion of regulation, Gillian Tett (2019) of the FT outlined:

"…three different regulatory systems in the world, at least when it came to finance.

In some countries, most notably the US, everything that was not explicitly banned by specific laws was permitted. In others, such as Japan, everything that was not explicitly permitted was considered banned. Then there was a third category of countries (including the UK) that had 'principles'- based systems: instead of relying on the letter of the law, these regimes preferred to outline general principles and apply them using precedent."[15] (FT, 8 June 2019)

[15] In similar fashion (and with characteristic irreverence), Tweedie used to joke: "in the UK everything is permitted unless it is prohibited; in Germany everything is prohibited unless it is permitted; in the Netherlands everything is prohibited even if it is permitted; in France everything is permitted especially if it is prohibited."

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Much of investment banking in London was by 1990 owned by US banks used to operating under the first regime described by Tett above. This had led the US standard-setters to respond by writing ever more detailed rules, in a game of catch-up. TCL describe Tweedie's exasperation in the 1980s – as technical partner in a major audit firm – with the scornful attitude of investment bankers who were constantly finding (and selling for lavish fees) creative accounting devices which were (just) compliant with the letter of the law and standards, but palpably at odds with the substance of those rules, the principles underlying the rules. Tweedie recalls one of the investment bankers telling him: 'You'll never stop us'.

Robert Bruce (2000) described the ASB's preference for the third way in Tett's scheme :

'In the past we seemed to be moving towards the American model. That meant a game of ever-tighter and more detailed rules as corporate entities found ways to leapfrog them. But the Tweedie approach cuts its way out of that. If you emphasise the basic principles, you can then enforce the details, not through rules, but through the force of argument which results in peer and market pressure.'

…'What is required, as Isobel Sharp [of Arthur Andersen] puts it is that the company law changes "should enshrine principles in law and leave the detail for elsewhere".'

The Law Society thought otherwise:

'We think therefore that the wish expressed by the Release [on off balance sheet finance] to substitute substance for form is a dangerous and undesirable one. More importantly … we consider that ....what is proposed is contrary to the law.' (The Law Society, 1986)

The FT picked up the dispute. Their editorial said (August 1987):

'The argument over off balance sheet finance has demonstrated the frailty of the accountants' 'true and fair' concept in the face of the determined defence by the legal profession of rigid statutes and the opportunistic exploitation of artificial schemes by merchant banks.'

The Dearing architecture supported the ASB by combining a legal framework with regulators' judgement. The Review Panel assessed accounts which appeared to contravene the spirit of the ASB's standards, and was able to demand that – if the company was at fault – it issue revised accounts. The offending company could appeal to the court. But, in Tweedie's words inTCW, 'as a lawyer would say to them: you'll win on a legal technicality if you win at all; but your peers have judged your accounts not to give a true and fair view. And that is damning.' In a case Tweedie cites, the top executives lost their jobs after a damaging decision by the Panel.

Presumably a lawyer would argue that if there were instances where the letter of the law had failed to secure compliance with its spirit, it was for the regulators to promote an updated law. But a recent example in an adjacent area of regulation – audit and governance – illustrates one drawback of such an approach. In May 2022 the British government decided not to submit to Parliament in the subsequent year a draft bill on audit reform. 'This, despite four years, three major reviews and a white paper, as well as rare consensus between regulators, companies and audit firms that new rules are needed, urgently.' (FT Leader 2022) Why did the government hold back this reform for at least a further year? In the FT's words, 'Apparently, government advisers think reforming the UK's corporate governance and audit market is "boring"'.

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A lag of five or six years between identifying a loophole in the law and legislating against it provides ample time for investment bankers and their legal advisers to profit from it, and to explore further devices to replace any that are eventually outlawed.

3.Relations with Government

The UK government was very supportive at the birth of the ASB. It was active in setting up the Board and enhancing its authority in the 1989 Companies Act. It engaged constructively through a senior official from The Department of Trade and Industry who had an observer role at the Board. But in the later years of the decade tension developed with the most powerful of government departments, the Treasury - over the reporting of liabilities incurred by government with investments under the Private Finance Initiative. The process was seen by the ASB as tantamount to off balance sheet finance, which the ASB had mandated in FRS 5 should be brought back onto the balance sheets of companies. The press relished the prospect of a fight in the London arena between two formidable Scotsmen, Gordon Brown (Chancellor) and David Tweedie (ASB Chairman)[16]. Robert Bruce (1998) observed in The Times:

'…growing arguments over the accounting treatment of the Government's Private Finance Initiative (PFI). The efforts to remove new hospitals, roads and prisons from the public sector borrowing requirement comes close to what, in the bad old corporate days of creative accounting, was known as off balance sheet financing.'

Accountancy Age thought this was a fight where the ASB was unlikely to prevail:

[The ASB] 'has dared to challenge the practice of off-balance sheet accounting for PFI…

According to a Treasury spokesman, several of the banks have already given their backing to the government.

…The opposition to on-the-balance-sheet PFI is too powerful. There is too much riding on this particular accounting standard. It would seriously jeopardise the government's tight spending restrictions. As a consequence, Sir David is likely to be cut down to size by the Treasury's iron chancellor.' (Bloom 1998, pp.14-15)

On the other side, the Financial Times saw hope that the ASB would prevail:

'The ASB under Sir David Tweedie has established a reputation and standing that no government could challenge lightly.' (Kelly 1998a)

But the Government resisted:

'Ministers have publicly warned that if the board, under the leadership of Sir David Tweedie, persists in its views they will simply allow them to be overruled by the Treasury…' (Kelly 1998b).

In the end the Daily Telegraph (1998) reported:

[16] Who happen to be alumni of the same university, Edinburgh, and to own homes not far apart from one another on either side of the Firth of Forth.

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‘The government has backed down in a dispute with the Accounting Standards Board that threatened its flagship private finance initiative.

Guidelines produced by the board today mean the government will bear the liabilities involved in large scale contracts such as prisons, hospitals and some roads, rather than the private sector.’

Cost-benefit analysis

In an appraisal of the efforts of the ASB, many of them directed at making a company P&L more reliable, the reader might reasonably ask for a ‘P&L’ for the 1990s ASB – a statement of the benefits and costs. This request might seem all the more reasonable in view of the ASB’s own sixth Fundamental Guideline:

‘To issue accounting standards only when the expected benefits exceed the perceived costs.’

And anyone familiar with the US literature might have low expectations of the net benefits in view of the contention of a well-known US academic commentator on accounting and financial standards, George Benston (1982), who opined:

‘The cost of an accounting standard, ex ante, is likely to exceed its benefits to shareholders’.

And as The Times wrote halfway through the ASB’s reform programme, Benston’s views were not confined to the US:

‘Britain’s new accounting standards have two main enemies: auditors who do not like the chosen treatment and companies whose financial engineering is thwarted. Both want to keep a choice of different accounting methods. In America, there is a third group that believes any official regulation beyond property rights is malign, destroying choice and sapping the vigour of market forces. Professor David Myddelton combines the two in a call for a bonfire of accounting standards, the Financial Reporting Council, and all its works.’ (Pennington 1995)

Perhaps this libertarian strand of thinking influenced Ernst and Young in their denunciations of the ASB?

Benston’s allegation that the costs exceed the benefits of standards is then significant in view of the ASB’s Fundamental Guideline. However, that Guideline continued with a caveat: ‘The Board recognizes that reliable cost/benefit calculations are seldom possible.’[17] Nevertheless, since the profession is devoted to holding participants in the rest of the economy to account for the costs they incur, perhaps the challenge from sceptics such as Benston and Myddelton does deserve some consideration in a paper aiming to review the ASB’s work: have we no quantitative information about the benefits and costs of the programme of more rigorous accounting standards such as the ASB introduced?

Perhaps the most obvious potential benefit for shareholders is avoiding losses of wealth arising from managers’ creative accounting. In one example of such loss of wealth cited earlier, Smith (1992) analysed

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[17] The Board does not abandon the objective:

‘However, it will always assess the need for standards in terms of the significance and extent of the problem being addressed and will choose the standard which appears to be most effective in cost/benefit terms.’

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the activities of the serial acquirer Coloroll in the years immediately preceding the founding of the ASB. It exploited many of the permitted accounting abuses described in TCW, which were curbed by the Standards of the nineties: spurious restructuring provisions, unwarranted asset write-downs, manipulation of goodwill, misrepresentation of gearing,… Just before it collapsed, almost worthless, it reported profits some ten times their likely true level[18]. The market value of shareholders' stake fell from over 400mn pounds to almost nothing.

But economists have argued that the harm from an overly permissive regulatory regime is not limited to - and often greatly exceeds - such losses of shareholder wealth. Nobel Laureate Akerlof (1970) wrote in his classic 'Market for "lemons"' paper (p.495):

'Consider a market in which goods are sold honestly or dishonestly: quality may be represented, or it may be misrepresented. The purchaser's problem, of course, is to identify quality. The presence of people in the market who are willing to offer inferior goods tends to drive the market out of existence. …It is this possibility that represents the major costs of dishonesty –for dishonest dealings tend to drive honest dealings out of the market. There may be potential buyers of good quality products and there may be potential sellers of such products in the appropriate price range; however, the presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business. The cost of dishonesty, therefore, lies not only in the amount by which the purchaser is cheated; the cost must also include the loss incurred from driving legitimate business out of existence.'

Lev (1988, p.7) applies the argument to the equity market:

'At the extreme, suspecting gross information asymmetries, uninformed investors may quite rationally withdraw from trading …altogether…A massive withdrawal of uninformed investors from the market …will deprive the economy of the allocational and risk-sharing benefits of large and efficient capital markets.'

Such benefits are hard to quantify. But suggestive evidence that they can be material comes from a number of sources. Shleifer and Vishny (1997) reported the assets of Russian oil companies being valued at a 99 per cent discount to those of their Western counterparts; and they attribute this in part to the potential plunder of assets by managers, because of weak monitoring and control arrangements, including accounting standards. Gwilliam, Macve and Meeks (2005) traced the growth of the Lloyds of London insurance market after a new regulatory regime was introduced incorporating modern standards of accounting and audit. This was prompted by scandalous abuse by insider agents of asymmetric information resulting in ruin for many ill-informed investors (who in this case did not enjoy limited liability). The new regime was followed by strong growth in the market (20% p.a. in the following five years). In another sector, UK manufacturing, Swann, Temple and Shurmer (1996) estimated the impact on the foreign demand for an industry's products when the British Standards Institute published standards for its products - export growth of towards 50% in one of their models.

Meeks and Meeks (2002) suggested two other potential benefits from effective accounting regulation. One was reduced search costs when investors or their agents are collecting financial data to inform stock market investment decisions. The study made a (qualified) estimate of the total search costs incurred by

[18] Statistical studies of share price movements do find evidence of shareholders being misled by opaque forms of creative accounting –e.g. Botsari and Meeks 2018.

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investors and their agents in managing the 1200billion pounds worth of shares of UK listed companies: around 2bn pounds. Modest reductions in such costs as a result of greater or better disclosures could then be material.

A second potential source of benefit they attributed to effective standards was in reducing contracting costs. Scott and Upton (1991, p.5) illustrate for debt contracts:

'Without a body of [accounting] standards, lenders would be forced to negotiate each set of contracts "from scratch". [Those contracting] would have to create their own comprehensive set of accounting rules rather than simply identifying supplemental rules or departures from GAAP'.

The benefit of 'off the peg' accounting measures can come not only in writing contracts but also in enforcing them (Whittington 1993).

So much for the potential benefits of effective standards. What about the costs of a regulatory regime such as the ASB's?

The direct cost of the ASB in this period was about 2mn pounds a year[19]. To put this in perspective, this was about one tenth of one per cent of another component of expenditure on monitoring UK businesses: the audit bill for UK companies at that time (Meeks and Meeks 2001).

Of course, standards impose additional compliance costs on preparers, and some (fairly heroic) estimates reported in Meeks and Meeks suggest an order of magnitude for these compliance costs of around twice the direct costs incurred by the regulator. One of the studies on which these data are based, by Carsberg and Page (1984), on the highly contentious and complex current cost accounting standard SSAP 16, concluded that 'the costs of preparing current cost information are quite low…hardly great enough to explain the strong opposition that some preparers show to current cost accounting' (p.176). Another study examined the compliance costs associated with the new accounting system at Lloyds of London mentioned above: compliance and audit costs were of the order of twice the (very modest) direct costs of regulation (Gwilliam, Macve and Meeks, 2005). Then, as noted above, the ASB field tested their proposals for goodwill accounting; and the resulting small estimates of preparation costs by the participating companies[20] helped win over finance directors to the new standard.

This is a tentative, incomplete and imprecise approach to assessing costs and benefits. It does not yield a neat bottom line. But perhaps, in the spirit of FRS3, such an information set, rather than a single 'bottom line' number, helps the reader to take a view – in relation to the ASB's work - on Benston's proposition that: 'The cost of an accounting standard, ex ante, is likely to exceed its benefits to shareholders'.

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[19] This is for the Financial Reporting Council in total, and is net of income from publications (Financial Reporting Council 2000, p.76). It excludes the pay of staff members seconded to the ASB by their employers.

[20] Guinness (which had substantial goodwill) found the test could be completed in two to three days by a recently qualified accountant; and that the test gave credible results (they had available independent, complex data on the value of their intangibles).

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The demise of the ASB – globalization

Somewhat paradoxically, in two respects the ASB's success made a significant contribution to its own demise. The ASB's work stimulated greater demand for cross-border investment in UK equities, and hence for internationally consistent accounting standards; and it contributed significantly to the supply of such standards.

Demand

First, it is arguable that the Board's restoration of trust in the accounts of British companies contributed – as Akerlof would predict – to the growth of the international market in shares. For example, between 1994, when the ASB was picking up speed in its reform programme, and 2000, when Tweedie and Whittington departed, inward portfolio investment in UK equities recorded a twenty-fold increase. And London played a disproportionate role in international M&A (Meeks 2003).

Just as market developments in the 1980s led to demands for more consistency and comparability in domestic reporting, so also the increased internationalisation of business (stimulated by the ASB) increased the demand for harmonization of accounting across jurisdictions.

That need is illustrated by the experience reported by Nobes (1997) of Daimler Benz when it was the first German company to list on the New York Stock Exchange. It therefore had to report its income using US accounting conventions, alongside the German ones it had been employing. The former (German) figure for 1993 was a surplus of DM615mn; the latter (US) figure was a loss of DM1,839mn. There was no suggestion of creative accounting: the company, and audit and financial regulation in its home country enjoyed a deservedly high reputation. The difference arose simply from different (defensible) accounting rules. But they obviously represented an obstacle to international integration.

Supply

The second reason the ASB contributed to its own demise was that it engaged energetically and constructively with efforts to harmonise reporting standards across national borders. Tweedie, Cook and Whittington were very well-informed about the harmonization challenge. Tweedie had been partner of one of the biggest international accounting firms; and he had been a very active member of G4+1 and the IASC (International Accounting Standards Committee); Cook's corporate posts had been in major multinationals, and he had worked with OECD as well as having a spell as Secretary of IASC; Whittington collaborated with researchers around the world.

A very significant fillip to harmonisation came with the European Commission's move to require listed companies in the EU to use IFRSs in their consolidated accounts from 2005: the ASB's role would then be limited to promulgating UK standards for non-listed companies and giving advice to the IASB. A number of attempts were made to foster liaison between the IASB and national standard-setters, but it proved hard to construct effective liaison arrangements, and as one of over a hundred participating countries, the UK could play only a minor role. As Cook wrote to me, 'The days of a powerful, independent UK Standard Setter with a major say in the development of international accounting standards were over'.

It can be seen as a compliment to the state of UK accounting in 2000 – compared with its international 'laughing stock' status when the ASB was founded – that the IASB was headquartered in London, and

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that Tweedie, Cook and Whittington were hired by the new body[21]. The development was inevitable if accounting was effectively to serve the globalizing market. But in TCW there are moments of regret about the diminished role of the ASB. As Tweedie commented, at ASB 'we set out with consent to get the 100 Group (of finance directors) on board, the technical partners on board and the analysts on side, with separate meetings. If we got all three of those we had a fair chance of getting the standard through. We didn't always make it, but that was the way we approached it. It was so much more difficult with IASB, because that happened in every blooming country'. And also, the strong representation of the US on the IASB increased the pressure to rely more on detailed rules than on the underlying principles.

Last words

Financial Director wrote, 'There is no single explanation as to why the ASB has been so universally hailed as a success: support of the profession; the time in the economic and political cycle when it was set up; the architecture of British standard-setting created by Sir Ron, now Lord, Dearing; and the fact that the team assembled stuck to the task.'[22]

Tweedie, Cook and Whittington would have given much of the credit to the very talented and highly committed Board members and staff they worked with. But the comment in *Financial Director* was right that 'the time in the economic and political cycle when it was set up' must have helped:

'In the 1980s, finance directors and auditors lost their way, seduced by financial engineering and creative accounting.

When the ASB took on its work, financial reporting was fast becoming a laughing stock. Companies reporting record profits and then collapsing shortly afterwards were not untypical. Now the UK is a major player globally on the financial reporting scene.'[23]

As usual after a crisis there was indeed an appetite for change. And the authors have acknowledged warmly the ingenuity of Dearing in creating an effective architecture to support change. But contemporary accounts are almost unanimous in emphasizing the critical role in delivering change of the actual people leading the ASB. Bruce (1997) gave his explanation of factors in the Chairman's success:

'Sir David has great clarity of mind and an amiable disposition. It means that he is able to tell people that they are wrong without them taking too much offence.'

'But beyond the charm lies the toughness. You do not manage to reform a whole range of financial reporting rules through which the finance directors of some of the country's finest companies had been managing to drive a coach and horses on the basis of a good repertoire of jokes and a pleasant manner. Sir David's secret lies in the combination of two factors. He is academically brighter than most accountants

[21] As Chairman, IFRIC Coordinator, and Board member respectively.

[22] Financial Director (1999,p.24) November.

[23] From the citation when Tweedie was given the Founding Societies Award (Accountancy Age 1997) 5 June.

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and he is, to most in the largest accountancy firms, an outsider. That combination allows him to note things that those who are more dependent on the culture of the Big Six would rather not. And it allows him to refute the arguments of others in a logical way.'

But the ASB was not a one-man show. Accountancy (2000) pointed out that:

'…in the background Sir David has been blessed with the perfect backroom genius, technical director Allan Cook.

The two often disagree but the partnership has thrived on a recognition that they bring different things to the party.' (Accountancy 2000).

Their partner, Geoffrey Whittington, brought complementary attributes. He is always at pains to emphasise that, in contrast with Cook and Tweedie, his contribution was only part-time, and lesser. But this member, 'among the world's leading academic accountants', was described as 'one of the most awkward and thoughtful' standard-setters of the time'[24]. When he followed Tweedie in receiving the Founding Societies Award, 'the accountancy profession's equivalent of the Nobel Prize, though without its money' (Bruce 1997), the citation said he 'played a pivotal role in the development of accounting standards….[and]….has played a major part in forming our world class standards.'

It is not surprising therefore, that although they had been labelled in the press– directly or indirectly – as 'the most hated accountants in Britain', the Queen chose to honour all three – Tweedie with a knighthood, Cook and Whittington as CBE. Always on the lookout for a smart hire, Her Majesty also made Tweedie her auditor[25].

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[24] In, respectively, Accountancy Age (1995) 12 October; Citation for award of Honorary Degree of Doctor of Science, University of Edinburgh,16 July 1998; and commentary by Robert Bruce (source lost).

[25] Chair of the Royal Household Audit Committee for the Sovereign Grant.

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