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# The Inflation Accounting Cycle: A British-Australian Comparative Perspective 1973–85

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*Herein we seek to extend understanding of the 'accounting-cycle' hypothesis by comparing the Australian, and United Kingdom (UK) experiences with inflation accounting during 1973–85. The existence of 'cycles' in accounting standard-setting was first suggested in respect of inflation-accounting by Mumford (1979), and subsequently generalised by Nobes (1991). The paper confirms that most of the phases identified by Mumford in respect of inflation-accounting cycles in the UK are, broadly, also identifiable in Australia. The Australian experience also largely confirms in relation to inflation-accounting Nobes' generalised, cyclical model of standard-setting in which change is driven by stakeholders with conflicting attitudes towards the degree of standardisation of treatments proscribed by accounting standards. While loss of interest in inflation-accounting in the UK is held in the Mumford approach to result from a decline in the rate of price inflation, we argue that in Australia, inflation continued at a high rate even after interest in inflation-accounting ceased. A counter hypothesis is suggested: that interest in inflation-accounting would have waned in the UK irrespective of the level of inflation. Although the Australian evidence supporting Nobes' cyclical concept is quite strong, the attitudes and behaviours of the various stakeholders in inflation-accounting standards were more diverse than assumed by Nobes. Complicating UK-Australia comparisons are differing socio-economic environments and political responses to the problems of financial reporting under high levels of inflation. The nature of these differences and the manner in which they may have affected inflation-accounting standard-setting is explored. Further, we argue that the atypical character of inflation-accounting makes it dangerous to draw too many parallels between inflation-accounting and other more-singular accounting problems in the context of developing accounting standards.*

## 1. Introduction

Determining appropriate methodologies to examine particular research questions is an enduring problem in the social sciences. In financial accounting, phenomena for which dependent and independent variables are both highly-specific and easily-measurable lend themselves readily to econometric techniques, particularly multiple-regression analysis. However, such techniques are inappropriate when concepts and/or key data elements are fuzzy and developments occur over extended time periods. Such scenarios are typical of those in which accounting standards are developed and implemented (or not implemented). In these circumstances, alternative techniques must be employed to examine the relevant processes and

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outcomes.

One such approach, premised on the existence of repetitive or 'cyclical' patterns in accounting standard-setting, was proposed by Mumford (1979:p98). Examining standard-setting developments associated with severe UK price inflation during the 1948–53 and 1973–78 periods, Mumford identified similarities between the two developmental sequences which were 'so marked and the steps so predictable that they are ... a blueprint for the next surge of inflation'. The 'cycle' that emerged from his analysis comprised an eight-stage chronological process.

Subsequently, Nobes (1991) advanced a different, and more-generalisable, cyclical standard-setting concept which he applied, *inter alia*, to inflation-accounting. Within a Mumford-type sequence of events in standard-setting, Nobes focused on the degree of freedom, or 'standardisation', permitted in accounting treatments. In Nobes' generalised scenario, predictable cycles of activity in standard-setting occur around the degree of standardisation required of preparers of financial statements. New or revised standards (or exposure drafts) contain relatively unconstrained requirements as to choice of accounting methods which then attract proposals for highly-prescriptive treatments, to finish with 'weak' relatively-permissive standards.

Although not explicitly acknowledged by Nobes, the implications of his generalised, cyclical model are profoundly pessimistic from the standpoint of advancing the degree of standardisation in financial reporting. The model predicts that the outcome of any standard-setting activity will be a return to a pre-existing degree of standardisation, although specific reporting requirements may change.

With their potential for deepening insights into standard-setting processes, cyclical models warrant further attention. However, their international generalisability must first be established. Although both Mumford and Nobes focused solely on the UK, Nobes (1991:p271) called for international comparisons to ascertain whether the UK pattern was replicated elsewhere. We respond to that call, using a comparative methodology, by examining the UK and Australian experiences with inflation-accounting during 1973–85.

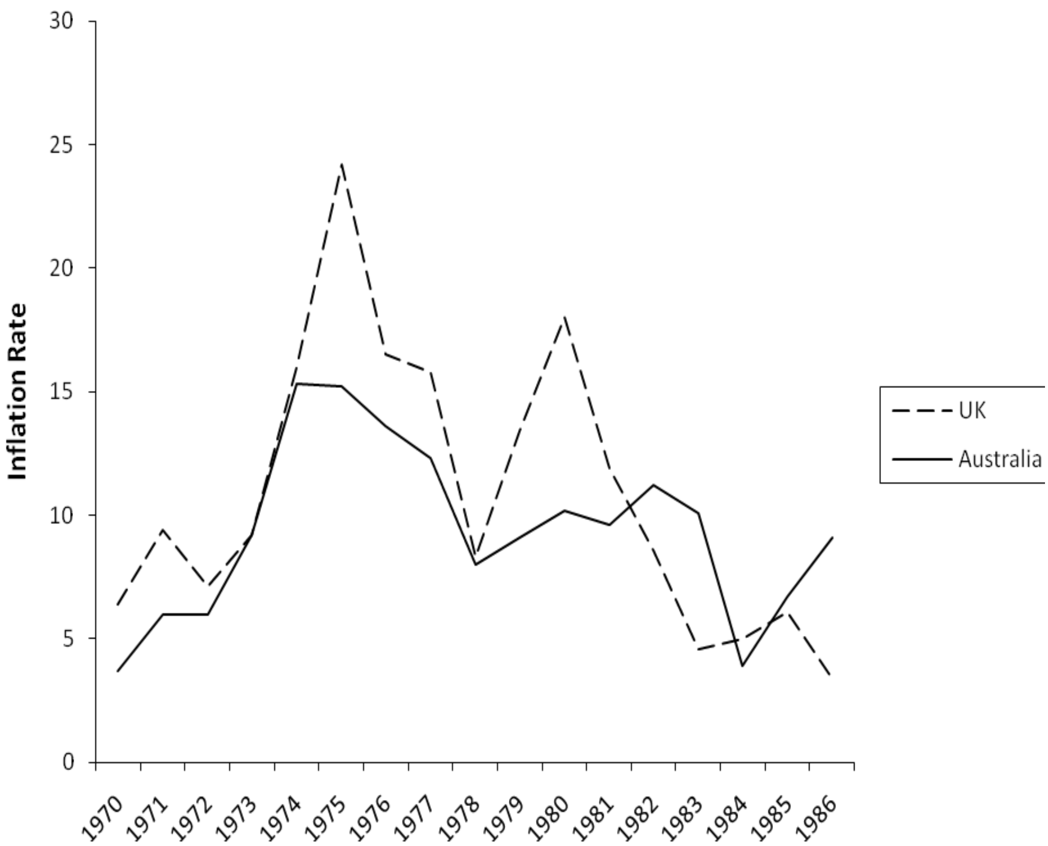
Australia is an excellent comparator for this purpose. Australia's initial and final inflation-accounting statements in the relevant period were based on contemporary UK pronouncements, although intermediate developments differed significantly between the two nations. Further, Australia's post-1972 inflation experience strongly resembled the UK's, differing mostly in that peak antipodes' inflation was somewhat less extreme. However, crucially for our analysis, historically high rates of inflation persisted longer in Australia than in Britain. Figure 1 shows the comparative inflation rates for both countries during the relevant period.

Evidence is produced herein of considerable similarities between the Australian and UK inflation-accounting cycles, both in the Mumford and Nobes versions. However, significant differences between the British and

Australian post-war experiences with inflation lead us to doubt the validity of Mumford's final stage in the inflation accounting cycle, namely loss of interest in reform following a reduction in the rate of inflation. In the early 1980s, Australia effectively abandoned inflation-accounting initiatives even though the inflation rate remained high by historical standards. Australia's experience suggests the following alternative hypothesis: had inflation in the UK continued at high levels, inflation-accounting efforts would have been scaled down and the problem of specifying an acceptable and standardised inflation-accounting model would have remained unresolved.

To support this alternative hypothesis, we provide evidence that social, economic and political differences, particularly in relation to the role of taxation, caused divergences between inflation-accounting cycles in Australia and the UK. Importantly, our analysis indicates that political events in Australia in the mid-1970s affected inflation-accounting developments, leading to the general proposition that political developments are likely to affect cycles in accounting standard-setting.

**Figure 1: UK-Australia Inflation Rates 1970–86**




To explore these issues, the remainder of the paper is structured as follows: Section 2 examines the Mumford-Nobes versions of the accounting cycle phenomenon. Australian inflation-accounting developments are summarised in Section 3. Section 4 explores differences in the British and Australian experiences with inflation, introducing several socio-economic indicators. These factors suggest that Australians generally held more-permissive attitudes towards inflation than Britons, which may account for the prolonging of inflationary experience in Australia. Section 5 offers concluding remarks and suggestions for further research.

## 2. The Mumford-Nobes Cycles of Inflation-Accounting

Mumford (1979) noted that the two inflation-accounting cycles in the UK, 1948–54 and 1973–78, appeared to follow similar eight-stage patterns of events in relation to the developmental process for accounting standards and the reactions of parties with stakes in the ensuing statements, namely:

1. an increase in domestic inflation and a fall in share prices[2];
2. reaction by the accounting profession;
3. intervention by government;
4. radical studies into inflation-accounting techniques;
5. controversy within the profession;
6. formulation of compromise recommendations;
7. reduction in domestic inflation and a recovery of share prices;
8. dwindling of interest in reform.

From his 1978 standpoint, and relevant to our case, Mumford recognised that the second inflation-accounting cycle was then incomplete. However, the rate of inflation was diminishing and interest in the problem was receding. Accordingly, he hypothesised that these factors would automatically end the cycle of standard-setting. Mumford concluded that the first seven stages of the 1948–54 cycle were replicated during 1973–78 and that there were signs that the final stage—dwindling interest in reform—was about to occur. Analyses of post-1978 UK inflation accounting developments by Westwick (1980) and Tweedie and Whittington (1984) seem to confirm Mumford's prognostication. The rate of UK inflation fell further and there was little additional inflation-accounting activity, although whether this inactivity was due to the inflation problem dissipating, or stalemate between rival views of how to deal with it, is debatable.

To facilitate subsequent discussion, it is helpful to elaborate on the key events marking several of Mumford's stages. Although authoritative professional statements marked stage 2 of both the 1948–53 and post-1972 UK inflation-accounting cycles their tenors differed significantly. Statement N12 *Rising Price Levels in Relation to Accounts* issued in 1949 in response to annual inflation rates in the 7–8 percent range, viewed inflation as a financial-management, rather than accounting, problem. Historical-cost-based accounts were considered adequate providing that company directors recognised rising replacement costs when appropriating to reserves, a view conforming to prevailing American opinion. In contrast, the 1973 ED8 *Accounting for Changes in the Purchasing Power of Money*, and the similarly

[2] Following Nobes (1991), we concentrate only on changes in the rate of inflation and ignore changes in share prices.

titled SSAP7 of 1974, proposed that current-purchasing-power (CPP) information should be provided in supplementary financial statements.

The UK government's (stage 3) response to late-1940s inflation was a Royal Commission into the impact of inflation on income and taxation, which saw these issues as separable. Its 1970s governmental counterpart was the appointment by the Heath government of the Sandilands Committee which ignored the accounting profession's preference for CPP and favoured current-cost accounting (CCA). In the early 1950s, the radical studies (stage 4) stage comprised elements within the accounting profession advocating the use of replacement costs for both accounting and tax purposes. In 1975, the Accounting Standards Steering Committee extended this approach into the more comprehensive and operational CCA system.

'Controversy' (stage 5) in the UK during 1949–52 was largely *between* professional bodies over the historical/replacement cost choice. In the 1970s, essentially the same controversy was played out *within* the dominant body, the Institute of Chartered Accountants in England and Wales. Complicating this debate was disagreement over whether the chosen system should have mandatory or optional supplementary status. Compromise suggestions (stage 6) in both the 1950s and 1970s were for supplementary calculations showing the effects of CCA adjustments for cost-of-goods-sold and depreciation and, in the later period, an additional adjustment in respect of monetary items (the Hyde Committee proposals).

Mumford's 'cycles' are defined by events, consisting either of tangible actions by involved parties or exogenous changes in the rate of inflation. Hence, in his model, the final stage of the standard-setting cycle is triggered by a decline in the rate of inflation. As such, his model is essentially descriptive and not generalisable to the broader standard-setting process, or, necessarily, to other jurisdictions.

In contrast to Mumford's inflation-specific cyclical concept, Nobes (1991) conjectured that a cyclical pattern, 'might be extensible to other [accounting] issues, countries or times', and demonstrated his cyclical model based on standardisation with respect to the UK standards for research and development (R&D), deferred taxation, merger accounting and goodwill.

In Nobes' generalised model, a cyclical pattern is established about an acceptable degree of 'standardisation' in reporting practices, that is, the degree to which all enterprises are required to adopt common accounting policies which limit choice in the selection of accounting methods. Parties affected by a standard vary in their attitudes towards standardised compared with non-standardised accounting treatments. The degree of standardisation existing at any point in time will reflect the relative strengths of the affected parties in the standard-setting process. In this model, a reporting *status quo* is disturbed when 'energy' is imparted into the system, caused either by dissatisfaction with a prevailing standard or a realisation that a standard is required for a hitherto unregulated issue. Phases in a cycle reflect responses to the shocks of altered circumstances by affected stake-holders. The cycle is completed when the energy imparted into the system is dissipated and the interests of affected parties are accommodated to the new circumstances.

In Nobes' cyclical standard-setting model, 'downward' and 'upward' forces contest the degree of standardisation embodied in proposed and eventual accounting-standards. Arising from the Watts-Zimmerman (1979) managerial self-interest thesis, 'downward' forces are associated with managers whose interests lie in the promotion of free choice of accounting policies and flexibility in reporting practices. In this model, managers are assumed to oppose income-reducing standards. In contrast, 'upward' forces are led by independent-minded members of the accounting profession, responding to perceived inadequacies in prevailing reporting regimes. These upward forces are responsive to perceptions of inadequacy expressed by government, academics and the financial press about the broader economic and social implications of permissive accounting-standards.

In summary, Nobes' generalised cyclical pattern of accounting standard-setting contains the following features:

- Nobes' notion of a starting point of low standardization;
- energy, or stimulus, imparted by criticism of existing financial-reporting practices or altered economic circumstances;
- energy, or stimulus, imparted by criticism of existing financial-reporting practices or altered economic circumstances;
- existence of a pro-standardisation force centred on senior members of the profession;
- an anti-standardisation force centred about management desires to pursue reporting flexibility and avoid income-reducing requirements, and,
- a concluding phase involving the issue of a 'weak', that is, permissive, standard.

Nobes' notion of dynamic interplay between upward and downward forces provides a persuasive explanation for the mechanics of standard-setting. In his scenario, standard-setting becomes a political contest between differing sectional interests regarding the degree of standardisation embodied in accounting standards. However, as Nobes (1991:p274) conceded, the degree of standardisation must be determined subjectively.

In his analysis of the 1973–78 UK inflation-accounting cycle, Nobes perceived a starting point of low-standardisation in the sense that there was no specific inflation-accounting standard. This low-standardisation assumption is questionable. Arguably, to the extent that the (largely) historical cost *status quo* concept standardised accounting practice, it did so in a way which maximised reported profits relative to the inflation-accounting alternatives of CPP and CCA[3]. Once the standard-setting process was

[3] It is assumed here that historical cost-determined profits are generally higher than the CCP or CCA equivalents. Further, Following Nobes (1991:p267) we assume that CPP-determined profits usually exceed the comparable CCA figures, although this point is not crucial.

energised by an inflationary surge, the upward and downward forces were liberated to pursue their self-interests. Initially, the upward forces, comprising senior members of the profession, academics and, eventually, government, considered that the CPP system was conceptually superior. Later, these forces swung to favouring the more income-reducing CCA approach. Predictably, managers opposed both approaches, particularly CCA.

From this ‘standardisation’ perspective, the CPP-based ED 8 and PSSAP 7 were both uncongenial to managers for embodying moderately income-reducing approaches, albeit only for listed companies on a supplementary basis. The withdrawal of PSSAP 7 represented a victory for the downward (managerial) forces. However, these downward forces were thrown on the defensive by the subsequent introduction of ED 18 which, with its requirement for mandatory CCA reporting, represented the high point of standardisation. The displacement of ED 18 by PSSAP 16, affecting only large companies, represented a dilution of this CCA-based standardisation. Moreover, the statement’s monetary-items adjustment generally enhanced the profits of affected entities. A further dilution occurred with ED 35 which required only supplementary CCA information. When PSSAP 16 was withdrawn in the low-inflation environment of the late-1980s, the reporting *status quo* in relation to inflation accounting was restored.

Significantly for comparisons with Australia, Nobes saw no tax influences in this UK-derived version of the cycle because the various inflation-accounting proposals were all predicated on the separation of accounting and taxable profits. This decoupling of accounting and taxation measures occurred somewhat inadvertently. Tweedie and Whittington (1984:p98) described how the Sandilands Committee, although charged with recommending an appropriate base for corporate tax, was unable to discharge this task. Instead, it ‘recommended a further enquiry into the taxation implications of current cost accounting’. In this respect, the 1948–53 and 1973–78 UK inflation-accounting cycles differ. Mumford’s (1979) account of the earlier cycle indicates that the tax-base was an important consideration to the parties.

## 3. Australia-UK Comparisons

Like Nobes, we consider only the second (post-1972) inflation-accounting phase. Although Australia’s inflationary experiences during 1948–53 resembled the UK’s[4], professional involvement in accounting-standards in the antipodes was in its infancy, and the profession’s technical resources were minuscule. Only seven statements on accounting principles were extant in 1948, six of which were virtual facsimiles of ICAEW recommendations. However, by the early 1970s, the Australian profession was better organised and possessed a research arm, the Australian Accounting Research Foundation (AARF), for technical support, although this body’s resources were then very limited.

[4] UK retail prices rose approximately 40 percent between the September quarters of 1947 and 1954; the comparable Australian figure was 95 percent.

To compare Australian and UK post-1972 inflation-accounting initiatives, two chronologies are provided. Appendix 1 lists actions by the Australian Commonwealth government and the accounting profession, most of which are on the public record. In Appendix 2, less-publicised 'background' matters bearing on inflation-accounting are shown. The implications of these chronologies for the Mumford-Nobes' versions of the accounting cycle will now be examined.

Mumford's stages 2 to 4—professional initiatives, government intervention and radical proposals—are identifiable in the Australian chronology but their sequence and durations are blurred. Intervention by the Australian Labor government was manifested in the appointment of the Mathews Committee in late 1974, charged with examining the effects of inflation and taxation on conventionally-measured business profits. The Committee sat during the early stages of professional initiatives on inflation-accounting and its report, recommending a current-value approach, just pre-dated the publication of the profession's CCA exposure draft. Thus, government involvement at least parallelled and, arguably, preceded professional initiatives. The Trading Stock Valuation Adjustment (TSVA) for taxation purposes was introduced by the government four months before the profession's provisional CCA standard was issued. Moreover, while the British government was merely seen to be acting when it appointed the Sandilands Committee, the Australian government actually acted, by modifying the tax system through the TSVA.

The Australian government concerned itself only with the taxation implications of inflation, not, like the British government, with the broader financial-reporting aspects. Burrows (1996:pp100-1) records that when, in October 1976, the Australian accounting bodies petitioned the Commonwealth government to establish a broadly-based CCA Steering Group, the recently elected Liberal prime minister, Malcolm Fraser, replied that the government would not initiate, but would ‘support the concept of such a group’. When the Group was established by the accounting bodies in March 1977, *inter alia* to ‘review any aspect of CCA and implementation’, the government requested only observer status. Contemporary CCA advocates in Australia, Balmford (1978), Droder (1978) and Rickard (1978) all drew attention to the lack of government involvement in the development of CCA. The Australian political cycle, discussed in the next section, may explain this taxation-only involvement.

The Australian evidence is strongly supportive of Mumford's fifth, 'controversy', stage. AARF-sponsored inflation-accounting forums in Sydney and Melbourne during February-March 1976, produced disagreement over both the fundamentals and details of CCA. Reporting on the forums, McKeown (1976) credited Professor R.J. Chambers with a 90-minute advocacy of the exit-value approach. A spokesman for Australia’s largest corporation, BHP Limited, favoured CCA but not the ‘profit result outlined in the [CCA] exposure draft’. Another corporate heavyweight, CSR Limited, supported CCA *providing* that the method was recognised for taxation purposes and was obligatory for all public companies. When AARF’s monetary items ED appeared in July 1978, the CCA Standards Committee (the AARF committee which developed the ED), approved the statement with one member dissenting from the 'principle of recognising gains and losses on monetary items in the context of CCA'[5]. The 'letters' pages of the September and October 1978 editions of the *Australian Accountant* revealed strong anti-CCA sentiments.

Mumford (1978) interpreted the Hyde Committee's November 1977 proposals for supplementary CCA data as a manifestation of his sixth, 'compromise', stage. In the antipodes, the decision in April 1978 by the Joint Standing Committee of the two Australian professional accounting bodies to schedule only the provision of supplementary, unaudited CCA statements could be similarly interpreted. Further, the issuance of the final CCA statement in August 1983 as a 'non-mandatory practice statement' represented an even weaker compromise, if not total capitulation.

Mumford's final stages, lower inflation and then, consequentially, dwindling interest in reform, are more dubious in the Australian connection. The position is complicated by the different agendas and attitudes of the two Australian professional accounting bodies and their research vehicle, AARF, which toiled during the late 1970s and early 1980s to develop a comprehensive (including monetary items) CCA standard and working guide. However, from early 1978 there was an obvious cooling by key personnel in the two professional bodies towards the implementation of any AARF-generated proposals for CCA. Although this cooling occurred after a significant drop in the annual inflation rate, from about 12 percent to 8 percent during 1977, the rate was still high in terms of both Australian historical experience and international comparisons. Moreover, inflation quickly worsened, averaging about 10 per cent annually during the late 1970s and early 1980s. Thus, in Australia, contrary to Mumford's suggested sequence, interest in the issue diminished while the inflation problem itself continued.

Unique Australian socio-economic factors, discussed in the next section, may have caused inflation to have been taken less seriously in the antipodes than in the UK, muting elements of Mumford's cyclical sequence. Alternatively, and as Mumford recognised, several years' experience with even higher rates of inflation may have created a public perception that annual rates of around 10 percent were quite modest, requiring no special action. A third possibility is that the complexity of inflation accounting, not reduced concern about rising prices, may have caused inflation-accounting initiatives to be, effectively, abandoned.

Australia, through AARF, pursued a particularly comprehensive and complex version of CCA, effectively requiring, as Balmford (1978) observed, CCA solutions to many unresolved problems of historical-cost accounting in inflationary circumstances. Perhaps the most complicated issue was the

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[5] Burrows (1996) contains a detailed chronology of AARF's efforts to develop an inflation accounting standard.

adjustment for monetary items. Reflecting on the CCA episode almost two decades later, Balmford (1995), who chaired AARF's Accounting (subsequently CCA) Standards Committee during 1974-78, averred that 'monetary items ... became the obstacle which seemed to make the whole approach [to CCA] too difficult to manage'. Difficulties with monetary items were not just an Australian phenomenon. Tweedie and Whittington (1984, p.143) opined that the UK 'MWCA [monetary working capital adjustment] caused ... more problem than any other aspect of the [ED 24] Exposure Draft'. More generally, the fact that the Australian profession undertook a huge and unprecedented educational program in connection with inflation accounting indicates the complexity of the issue. In late 1975, the Institute of Chartered Accountants in Australia ran 15 workshops attended by 1325 chartered accountants Australia-wide to explain the CPP and CCA preliminary EDs. In 1979, the Institute and the other major accounting body, the Australian Society of Accountants (now CPA Australia), combined to organise 24 workshops nation-wide to explain the CCA proposals. The argument that inflation-accounting endeavours ceased, in part because of the complexity of the issues, has validity but is contrary to Mumford's explanation for the cessation of the inflation-accounting cycle.

Key elements of Nobes' cyclical approach can be identified in Australia. There was a starting point of low standardisation in the sense that inflation-accounting was constrained only by accounting standards framed primarily on the basis of historical costs. Arising from the energising process associated with rising inflation rates, the provisional CCA standard, embodying mandatory reporting, was the high point of standardisation and income-reduction. Subsequent moves towards supplementary and then voluntary disclosure are consistent with Nobes' cyclical concept, as was the introduction of the monetary items adjustment with its (for many companies) income-enhancing effects. However, the actions of the various parties, particularly government, in the Australian developments differ somewhat from Nobes' scenario.

Consistent with Nobes' analysis, the upward forces in Australia comprised senior members of the profession and many academics. However, the role of government in Australia differed from that in the UK in relation to both financial-reporting and taxation aspects of inflation-accounting. By implementing the TSVA, the Australian government became a conspicuous 'upward' force in inflation-accounting. However, in terms of more-general financial reporting, the government, judged by its attitude towards the creation of, and participation in, the CCA Steering Group, was a neutral force, seeming to prefer to leave resolution of financial-reporting issues to the professional and business communities.

These postures contrast with those of the UK government. The Sandilands Committee had effectively neutralised taxation as an inflation-accounting issue while actively over-riding the professional and business communities by promoting CCA rather than CPP. The actions of the UK government suggest that it had two separate policy objectives. First, was not to upset, through inflation-adjustments, the balance of resources flowing to the financially hardpressed Treasury. Second, was protection of the City of London's position as a major international financial centre. The UK government seemingly doubted the financial community's ability to solve the problem of what to do about inflation in financial reporting without government involvement or formal supervision.

Management in Australia was a more varied player than Nobes' scenario allows. Within this group, the downward (anti-standardisation) forces were probably more numerous than their upward opponents, but the latter had considerable strength. These attitudes are easier to demonstrate with respect to income reduction than reporting flexibility. CCA advocates certainly recognised managers' distaste for profit-reducing reporting concepts. Rickard (1978:p408) then deputy chairman and later chairman of AARF's CCA Standards Committee, acknowledged that:

> "Company directors and managers who thought that their results, when reported more realistically, would appear less favourable, could be expected to oppose CCA or any other accounting system having a similar effect."

As chairman of Lloyds International Ltd and a former finance director of steel-maker John Lysaght (Australia) Ltd, Rickard knew first-hand management and board attitudes. Compelling evidence of management self-interest causing financial-reporting opportunism is Kirk's (1979:p45) observation, in connection with the announced withdrawal of the TSVA, that:

> "…the fact that most companies actually used the TSVA to add further to distributable profits did not pass unnoticed by the Treasurer and was implicitly part of his rationale for dropping the allowance."

However, Nobes thesis implies that, given reporting discretion, managers will avoid reporting CCA results if these show lower profits than conventional reporting. Whilst Parry's (1980) survey of the 1979 financial statements of 230 Australian companies and public enterprises, largely supports this non-disclosure thesis, it does not do so entirely. The extant provisional CCA standard strongly recommended disclosing the current costs of fixed assets, inventories, depreciation, cost-of-goods-sold, and, less strongly, gains or losses on monetary items. Five companies provided complete CCA-based accounts, another three reported supplementary CCA data while several others included in their main accounts CCA-type asset revaluations or depreciation charges. Mining, resources and manufacturing companies dominated the concerns making these voluntary disclosures. Spokesmen (mostly non-executive chairmen) for some of these companies also featured in a 1979 film commissioned by AARF, extolling the benefits of CCA. In extracts from the script cited by Romano and Wise (1986), the nexus between profit measures and capital maintenance was the dominant theme of directors' comments.

These minority pro-CCA comments suggest that it is simplistic to associate management self-interest principally with reported profits. To the extent that a company's taxes are reduced its free cash flows are increased, creating expansion and other opportunities from which managers can benefit. Thus self-interested managers and directors face something of a dilemma when taxation and financial reporting issues are linked. Taxation is a zero-sum game if tax changes are associated with attempts to maintain total tax receipts. It is not surprising that miners and manufacturers, the obvious beneficiaries from current-cost-orientated tax changes, were most likely to support CCA if there was any prospect of parallel changes to the taxation system. In the service and finance sectors, support for CCA was less likely and opposition more probable. Thus taxation probably divided the corporate sector in its approach to CCA.

The concept of 'management' in the managerial self-interest thesis requires clarification. Financial-reporting policies are influenced by non-executive directors as well as their executive colleagues. The interests of executive and non-executive directors are not identical, particularly if the latter have diversified portfolios of directorships. Diversified non-executive directors can probably take a broader view than executives of a company's affairs and the implications of financial-reporting practices. In a variation of the political-cost assumption, such directors may see political benefits in reporting practices which reduce profits if their agenda is to alter the basis of company taxation. 'Management' may not be as monolithic as Nobes' analysis implies.

## 4. Economic, Political and Social Influences

Differing Australian-UK political cycles may have caused the pattern of inflation-accounting developments in the two nations to diverge. In 1972, Australia elected its first (Whitlam) Labor Government for 23 years which governed until dismissed in extraordinary circumstances in November 1975, when it was replaced by a 'conservative' coalition government with a broadly 'dry' approach to economic policy. In the UK, the Labour party under Harold Wilson replaced the 'wet' Tory government of Edward Heath in 1974, and was followed by the Callaghan Labour government which continued until 1979. The 'wet', interventionist, approach continued longer in the UK than in Australia.

In Australia, the Mathews Committee was commissioned by the Whitlam government, but no action had been taken on the Committee's recommendations when that government was dismissed. In its campaign speech, according to Droder (1978:p62), the future conservative coalition government promised: to implement within three-years the Mathews Committee's recommendations that:

> " … plant and equipment should be depreciated on the basis of replacement rather than historical cost and that companies should be permitted to revalue their opening stocks at end-of-year prices."

It is a matter of record that for a triennium only, the TSVA was operated for *half* the opening inventory figure. This history is recounted not to show the mendacity of politicians but to illustrate that what was considered to be a 'business friendly' government was keen to be making some gesture towards business. The TSVA proposal was on the shelf, relatively simple and could be implemented quickly. Moreover, it could be introduced partially, minimising the cost to revenue of this business-friendly gesture. In fact, the TSVA was phased out by 1979 although an investment allowance, initially 40 percent but reduced to 20 percent from 1978, was continued until 1986.

However, involvement in more complex and problematic financial-reporting reforms may have posed problems for an Australian conservative government whose members had previously given little thought to the issue. Further, there was no predicting where involvement might lead. A longer-established government, may, as in the UK, have responded more positively in a general way to inflation-accounting, particularly after the Sandilands Committee conveniently decoupled the taxation and accounting elements. It is a reasonable hypothesis that the different interactions of the political and inflation-accounting cycles in Australia and UK caused divergences in the progress of the latter.

Thus far it has been assumed that a given level of inflation causes similar concern (or indifference) among Australians and Britons. If this assumption is incorrect, then different social attitudes to inflation may influence a cycle, weakening or delaying the initial 'energising' stage and causing earlier apathy when the problem appears to recede. Arguably, Australians have, historically, demonstrated a higher tolerance for inflation than Britons, other Europeans and Americans. Press comment on public attitudes to Australia's low-inflation experience in the 1990s support this view. For example, the editorialist in the national daily, the *Australian*, on 28 July, 1995, attributed Australians':

> " … apparent ingratitude towards the Government for holding [1990s] inflation down ... [to the] culture, habits and expectations of postwar Australia during the last 25 years ... Australians expect economic booms to produce rising inflation, rising wages and, above all, a boom in housing prices."

Other commentators, for example, Walsh (1994) and Mitchell (1995), also reported that low inflation was causing political problems for the Australian government through voters, conditioned to rising house prices, suddenly confronting stable, or falling, property values. This attitude is related to, but is of a different order than, the negative-equity sporadically experienced by entrants to the UK housing market since the late-1980s. That there are good socio-economic grounds for the journalistic impressions of Australians' permissiveness towards inflation is suggested in Table 1, showing comparative social indicators which provide some economic basis to the proposition that attitudes to inflation may differ between the two countries.

## Table 1: Comparative Social Indicators Australia-UK

| | Australia | UK |
|---|---|---|
| **Proportion of dwellings owner occupied** | 68.7%(1971) | 49.6%(1970) |
| **Proportion of population aged 65+** | 8.3% (1970)<br>10.5% (1985) | 13.4% (1971)<br>15.0% (1985) |

**Sources:** Australia: *Year Book of Australia*.
UK: Central Statistical Office; Office of Population Census and Surveys

Inflation is problematic for individuals who do not hold appreciating real or financial assets. Also at risk are fixed-income recipients who have no automatic inflation protection. While ownership of dwellings provides only a partial measure of the composition of wealth, the much higher rate of home ownership in Australia then prevailing indicates that *ceteris parabus* property-owning Australians may have reacted with more equanimity to inflation than renting Britons. Australia's more youthful population, a consequence of mass post-war migration targeted towards persons of working age and young families, also produced a nation with fewer aged-pensioners and fixed-income recipients than Britain during the relevant period. Moreover, for most of the twentieth century, a substantial proportion of Australians worked under the protection of industrial award systems concerned with providing ‘wage justice’ to employees. Typically, awards contained explicit inflation-indexing provisions for wages and salaries. In this regime, home-owning workers stood to gain from capital appreciation (real or illusionary) resulting from inflation. All these factors are likely to have caused a particularly permissive attitude towards inflation by Australians.

## 5. Conclusion

Accounting cycles, both in the descriptive-chronological version proposed by Mumford and in the dynamic-behavioural variant advanced by Nobes, are potentially important tools for analysing the development of accounting standards and predicting the outcomes of standard-setting initiatives. Currently, predictions based on cyclical patterns seem wholly pessimistic about the possibility of existing standard-setting processes advancing standardisation in financial reporting. For analytical and predictive purposes, it is important that the sequence described by Mumford, and the behavioural patterns and outcomes predicted by Nobes, are confirmed.

The Australian experience with inflation-accounting during 1973–85 is largely confirmatory of all but the last stage of Mumford’s inflation-accounting cycle, albeit with some blurring of the early sequence. The Australian experience recounted here indicates that the causation of Mumford's concluding stage is not invariable, and suggests the counter-factual proposition that had Britain continued to experience a high (say about 10 per cent annually) rate of inflation, interest in inflation-accounting proposals may still have evaporated. This hypothesis is offered somewhat tentatively because of different socio-economic settings in the two countries which may have engendered a greater tolerance of inflation in Australia than the UK. Research would be advanced by identifying other nations in which uncomfortably high inflation rates persisted longer than in Britain but in which inflation-accounting projects were undertaken.

The Australian evidence supporting the generalisability of Nobes' version of the accounting standard-setting cycle is reasonably strong. Certainly, the interplay of opposing interests in standardised inflation-accounting methods is detectable. Similarly, the prediction of a return to a non-standardised reporting regime is fulfilled. However, the behaviours of the affected parties were more varied and complex than Nobes' thesis suggests, partly influenced by the extraordinary political circumstances prevailing in Australia during the mid 1970s and differences in the political cycles in Australia and the UK. More generally, the attempt to test the applicability of the Mumford-Nobes inflation-accounting cycles to Australia, suggests that international comparative studies need to recognise the possible effects of economic, political and social differences.

In important respects, inflation accounting is an atypical standard-setting issue. Underlying different inflation-accounting proposals are competing theories of accounting (proprietary and entity) and divergent socio-economic perspectives. In effect, inflation accounting proposals involve the development of mini conceptual-frameworks for accounting. As such, inflation-accounting raises much more fundamental and comprehensive problems than other more-singular financial-reporting topics. The Mumford-Nobes investigation of cycles in accounting standard-setting suggests an alternative approach to examining financial-reporting topics such as research and development, deferred taxation, merger accounting, goodwill, intangibles and fair value.

Herein we have extended the Mumford-Nobes' ideas of cycles of repetitive patterns in the standard-setting process to a comparative examination of the approach to inflation-accounting followed in the UK and Australia, nations which exhibited different socio-economic characteristics in the 1970s. Although each society exhibited enthusiasm for the adoption of CCA models, the responses in Australia and Britain varied according to socio-economic factors present in each society. We also find that interest in CCA models differed in each society as the effect of inflation varied in response to local and social circumstances, suggesting that interest in CCA models was not drive purely by the weight of intellectual ideas. The chronology presented herein illustrates the idea that the character of financial reporting emerges in the circumstances of the times; that it is a social construct and bends with human circumstances, particularly during crises.

From the perspective of the year 2010, when the CCA models of the 1970s have seemingly been consigned to history, our study predicts that the current approach of fair value will respond to different regional and social circumstances in the globalised economy that has emerged in the intervening years. While a globalised commercial-landscape has blurred national distinctions, the experience of the global financial crisis has illustrated the existence of a regionalism in accounting standard-setting, driven by differing socio-economic circumstances. For example, where the socio-economic circumstances of the crisis were similar in the US and Europe, there was intense interest in the application and consequences of the fair-value approach to measurement. However, in Australia, which is a party to the international fair-value approach, the socio-economic effect of the financial crisis was cushioned by sounder financial-system regulations and a political-consensus less wedded to debt. In these more favourable economic circumstances, interest in the use of fair value was a peripheral matter.

Combining the Mumford-Nobes ideas of cycles in accounting standard-setting with a comparative methodology, our study illustrates the usefulness of alternative methodological approaches to the study of financial-reporting problems. The approach adopted herein goes beyond reference to a purely mechanistic model of the working of financial society and examines financial reporting as a social construct. It considers the influence of changing human factors on financial reporting. In that way, our study reflects Hopwood's (2008) call for a broader examination of the context and the consequence of financial reporting.

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## Appendix 1

### Actions by the Australian Accounting Profession and Government

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| June 1974 | Request by Australian accounting bodies for the [Australian] Accounting Research Foundation to 'develop an Exposure Draft on ... inflation accounting as a matter of urgency'. |
| Oct. 1974 | Preliminary ED *Accounting for Changes in the Purchasing Power of Money*, (based on the CPP-based UK document PSSAP 7) |
| Dec. 1974 | Federal Treasurer appoints a committee, chaired by Professor R.L. Mathews, to report on 'questions relating to the effects of inflation on taxation paid by persons and companies'. |
| May 1975 | Mathews Committee recommends, *inter alia*, using the current value concept of income as the taxation base for businesses. |
| June 1975 | Preliminary ED, *A Method of Current Value Accounting* |
| Sept. 1975 | *A Comparison of Accounting Measurement Systems* issued by the [Australian] Accounting Research Foundation |
| July 1976 | Trading Stock Valuation Adjustment (TSVA)—a partial current value approach to trading stocks—introduced for taxation purposes. |
| Oct. 1976 | Provisional Accounting Standard *Current Cost Accounting* (CCA-based but excluding monetary items) |
| July 1978 | ED *The Recognition of Gains and Losses on Holding Monetary Items in the Context of Current Cost Accounting* (Monetary Items ED) |
| June 1979 | TSVA withdrawn |
| Aug. 1979 | Revised Monetary Items ED |
| March 1980 | ED *Current Cost Accounting – Omnibus Exposure Draft* (including CCA treatments of investments, intangible assets, tax-effect accounting and non-monetary liabilities) |
| April 1981 | Selective exposure of revised CCA Statement (adapted to resemble the UK document SSAP 16) and Working Guide |
| Aug. 1983 | CCA Statement issued as a 'non-mandatory practice statement |

## Appendix 2

### Other Australian Developments and Actions

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| Feb. 1976 | Inflation accounting forums, organised by [Australian] Accounting Research Foundation, held in Sydney and Melbourne. |
| Mar. 1977 | The Public Accountants' Co-ordinating Committee of the Australian Society of Accountants (the Society) doubts the Society's capacity to support an adequate CCA program and requests deferral of CCA implementation. |
| Mar. 1977 | The Society and The Institute of Chartered Accountants in Australia (the Institute) establish a CCA Steering Committee, involving the two accounting bodies and eight other organisations interested in financial statements to 'review any aspect of CCA and its implementation'. |
| Feb. 1978 | The Society's Executive doubts public support for mandatory CCA disclosure. |
| April 1978 | The Joint Standing Committee of the Society and the Institute set a timetable only for supplementary, unaudited CCA data. |
| Dec. 1978 | The Institute of Directors opposes supplementary CCA statements. |
| Mar. 1979 | Mr V. Prosser, newly appointed executive director of the Institute, comments that CCA 'is still regarded by some sections of the community as indigestible'. |
| Dec. 1979 | Mr P.J. Davidson, president of the Institute, remarks that the Australian profession was 'probably unwise in initially pushing for fully integrated CCA accounts'. |