

The Tangled Web of Price Variation Accounting

The Development of Ideas Underlying
Professional Prescriptions in Six Countries

Frank Clarke



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Frank Clarke
May 1982

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FOREWORD TO SERIES

During the 1960s and 1970s a remarkable series of books were produced by academic staff in the field of accounting at the University of Sydney. All were out of print. The Accounting Foundation believed that they should be made available to a new generation of scholars and researchers.

First and foremost amongst these was *Accounting, Evaluation and Economic Behavior (AEEB)*, written by the University's foundation professor of accounting, R.J. Chambers and first published in 1966. Several distinguished scholars have acknowledged that *AEEB* was a pivotal contribution to the development of the 'decision usefulness' theme in accounting research. It presented a systematic argument for the clarification of the meaning of key accounting concepts (such as 'asset', 'liability', 'equity', 'revenue' and 'expense'). It argued that there was a need to identify the property of assets and liabilities to be measured in accounting—with Chambers proposing the use of current market prices, or contemporary cash equivalents. It also argued for the use of adjustments to the application of money as a measurement scale when there were changes in the purchasing power of money. Decades later, many (though not all) of these ideas were adopted by the international accounting profession, when profession-sponsored bodies published 'statements of accounting concepts' or statements of conceptual 'frameworks'.

Chambers was a prolific contributor to research journals and many of those journal contributions are now available in electronic form. Amongst his later contributions in book form was *Securities and Obscurities*. When first published Chambers freely acknowledged that it was a polemic. Readers are left in no doubt that the world would be a better place if there was widespread adoption of 'continuously contemporary accounting'. Suffice it to observe that during the 1960s, questioning of the 'historical cost' model of accounting was often regarded as a form of heresy. By 2006, a surprising proportion of accounting standards now prescribe the use of market values in asset or liability valuation.

But arguably Chambers' greatest legacy at the University of Sydney was his encouragement of scholarly endeavour by colleagues and students.

The other books re-published at this time were all initially based on research undertaken by academic staff during the 1970s and early 1980s. The topics reflect the diversity of interests of the 'Sydney school' at that time: Clarke (1980) on the history of price level accounting, Walker (1978) on the history of ideas about the preparation of consolidated statements, Wells (1978) on accounting for common costs, and Wolnizer (1987) on auditing as independent authentication.

It was a period when academic research was largely analytical rather than empirically-based; and when the interests of academics at Sydney were largely directed at questioning the status quo—whether that be expressed in the way accounting or auditing was practised, or in the conventional wisdom as expressed in text-books of the time.

The interests of accounting academics have changed over time. But this collection of works displays the heritage of the University of Sydney in scholarly research and advocacy of the 'decision usefulness' theme in accounting.

(Neil Wykes)
President, Accounting Foundation
University of Sydney

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SYNOPSIS

From 1963 to 1980 the professional accountancy bodies and various Government committees in the countries covered by this study issued research studies, discussion papers, exposure drafts, reports and standards on incorporating price and (or) price variations in company financial statements.

The primary ideas underlying the prescriptions they contained emerged during the first twenty-five years of this century.

The development and subsequent use of those ideas has been undisciplined, often without regard for the contexts in which they first arose or for the specific purposes they were intended to serve.

None of the professional prescriptions examined in this study has specified adjustments by virtue of which both the decline in the general purchasing power of money and the differential movements in prices which characterize inflation, would be brought into account.

That failure appears attributable: in part, to insufficient attention being given to the general exchangeability of money for goods and services and to the specific exchangeability of vendible physical goods for money; in part, to the drift of ideas underlying the significance of replacement prices in determining a basis for setting utility rates into the unrelated general context of external financial reporting as a tactic to bolster the taxation case; in part, to careless recourse to the literature of other disciplines, as a kind of 'appeal to authority' in support of particular adjustments proposed to account for inflation; and in part, to pervading attitudes of inertia and compromise, in which the technical aspects of financial calculation in general and calculation of general purchasing power in particular were subordinated and the increased complexity of the proposed adjustments improperly presented as technical refinement.

As a consequence of those factors the professional prescriptions in every instance failed to achieve what was intended by them. CPP (GPP) accounting neither accounted for general purchasing power gains and losses incurred by companies, nor restated their

financial statements in terms of homogeneous and contemporaneous general purchasing power. Replacement cost, current value and CCA prescriptions did not produce data indicative of the financial progress or position of companies, or indicative of the capacity of those companies to continue their previous activities. The combined CCA/CPP prescriptions increased the complexity of the adjustments without any corresponding increase in their serviceability as complete accounts of the financial affairs of firms.

The transition from CPP accounting to CCA, to CCA/CPP, has been characterized by *ad hoc* and misdirected prescription for the adjustment of conventional (historical cost) data. Old ideas have been recycled. In no instance did the adjustments correct the mathematical impropriety of conventional data in any substantial way; under some schemes it was aggravated. In no instance did the adjustments improve upon the serviceability of conventional data in those general uses made of accounting information. In many instances they created additional anomalies in accounting data. Only in demonstrably imperfect ways did those schemes stumble towards a signalling system, the signals of which would correspond with the consequences of experienced events from time to time. The recycling of ideas has been unproductive.