THE ACCOUNTING STANDARDS COMMITTEE

SUPPLEMENTARY JOINT OPINION

1. This Opinion is intended to be supplementary to our Joint Opinion dated 13 September 1983. We do not propose to repeat the contents of that Opinion more than is necessary in order to make this one intelligible. The two Opinions should therefore be read together.

2. The ASC proposed to issue a Statement of Intent concerning the future of SSAP 16 "Current Cost Accounting". In summary, the proposal is that as public limited companies ["PLCs"] other than insurance companies, property companies and investment-based companies ["value-based companies"] should show the effects of changing prices when these effects are material but should be indicated in a note and not in separate current cost accounts. The present position is that SSAP 16 applies only to large and quoted companies (as therein defined) and does not apply to value-based companies, whatever their size. The ASC is not satisfied that a method has yet been developed for producing useful information about the effects of changing prices on the businesses of private companies and value-based companies at a cost that can be justified. It is therefore commissioning further work on the application of current cost accounting to these companies. However, the ASC draws attention to the principal factors which have led them to their conclusion that significant benefits result from the disclosure of current cost information by PLCs, including the large number and wide range of users of their accounts and in many cases the sophistication of those users. These factors generally do not apply to private companies. The benefits of providing information about the effects of changing prices on the businesses of private companies are therefore likely to be significantly less than in the case of PLCs.

3. The Statement of Intent therefore recognises that while in principle and subject to cost-effectiveness, all accounts should, in order to give a true and a fair view, show the effects of changing prices when such effects are material, there are practical difficulties about devising cost-effective methods for implementing this principle in the case of certain companies.

4. This practical approach has been criticised on the ground that if a footnote about the effects of changing prices is regarded as necessary for accounts to give a true and fair view, this requirement should apply to all sets of accounts. Questions of cost and expediency are said to be irrelevant to whether or not the accounts give a true and fair view and it is argued that there can be no justification for the ASC distinguishing between different kinds of companies.

5. We think that this criticism is misconceived. In the first place, questions of cost-effectiveness are in our opinion relevant to whether accounts give a true and fair view or not. "True and fair view" is not an absolute and unique concept. If that was what the legislature had meant, it would no doubt have said "the true and fair view". More than one view may be true and fair and whether a particular set of accounts satisfies this test or not involves questions of degree and a consideration of many factors relating both to the affairs of the particular business and the reasonable expectations of the people likely to use the accounts. In paragraph 7 of our Joint Opinion we said:

> "Again, because "true and fair view" involves questions of degree, we think that cost-effectiveness must play a part in deciding the amount of information which is sufficient to make accounts true and fair."

Some elaboration of this statement may be useful. The information contained in accounts may vary in its comprehensiveness, usefulness and degree of precision. These are all factors which bear upon the question of whether the accounts are "true and fair". The accounts must satisfy criteria of acceptability in regard to each of these and other matters. But the question of whether it is necessary for particular kinds of information to be included must take into account the cost and difficulty of providing such information. There is in our opinion nothing illogical in saying "This information would be useful to (say) investors in assessing the condition of the business. If it could be provided relatively easily, we think that fairness to investors demands that it should be included. *Prima facie* therefore accounts which do not include such information would not be true and fair. On the other hand, if the information could be provided only with great expense and difficulty, we do not think that it would be reasonable to insist upon it. Therefore we would accept accounts without such information as still being true and fair." [1]

6. In our earlier Opinion we mentioned for another purpose the analogy of the legal concept of reasonable care. On this point too, we think that reasonable care provides a useful comparison. The question of whether a person has taken reasonable care to guard against some

[1] In saying that we have in mind expense and difficulty applicable to any company of that kind, we are not saying that it would be right to take into account the difficulty which a particular company might have in providing certain information, e.g. because its records had been badly maintained. There is again an analogy here with "reasonable care" (see paragraph 6) in which difficulties or handicaps peculiar to an individual are usually disregarded on the ground that a person suffering from such a difficulty or handicap should not have undertaken the activity which gave rise to the risk.

danger depends upon weighing a number of factors, including the likelihood that the risk may materialise, the seriousness of the loss or injury which may be caused if the risk does materialise, the importance of the activity giving rise to the risk, and the cost of taking various kinds of precautions. As Lord Wilberforce put it, more succinctly than we have done:

> "What is reasonable depends on the nature and degree of the danger. It also depends upon the difficulty and expense of guarding it." [2]

This process of weighing risks against the difficulty and expense of guarding against them would apply equally to the question of whether an accountant had taken reasonable care in the preparation of a set of accounts. And although the question of whether reasonable care has been taken in the preparation of accounts is not the same as whether they are true and fair, we think that the questions of "reasonableness" and "fairness" have enough in common to make the analogy a valid one.

7. At this point the critic may say: "Well, I can see that questions of cost-effectiveness may enter into the decision on whether accounts are true and fair and that information about the effects of price changes may have to be given in the accounts of some companies but not others. But the SSAP should still be capable of expression in general terms. How can one justify an arbitrary dividing line which requires such information in the accounts of one company which happens to be a PLC and does not require it in the accounts of a private company of the same size and carrying on a substantially similar business?"

8. This criticism in our opinion misses the true function of SSAPs, which is to reduce the level of abstraction at which rules of good accounting practice are expressed. The more abstract the rule, the more pure and universally applicable it is, but the less useful it is to the practitioner seeking to apply it to the facts of a particular case. If universality were all that one wanted, the proposition that accounts should be true and fair would be sufficient. The point of an SSAP is to concretise that proposition, while recognising that every case must depend upon its own facts and that any rules expressed at a lower level of abstraction must to a greater or lesser extent be "rules of thumb". This point is made with great clarity in the Explanatory Foreword. We therefore see nothing illogical in an SSAP which gives guidance to the profession by taking a (necessarily) arbitrary but practical dividing line and saying that for PLCs which are not value-based companies it will ordinarily be

---

[2] Herrington v British Railways Board (1972) A.C. 877,920.

assumed that the public benefit from the provision of information about the effects of changing prices will be sufficient to justify the cost of providing such information, whereas this will not be assumed, or will not yet be assumed, in the case of private or value-based companies.

9. We said in our earlier opinion that "true and fair" was a dynamic concept and that its detailed content could change by degrees over time. We also said that one of the functions of the ASC was to initiate and promote such changes. An SSAP I accordance with the draft Statement of Intent seems to us to give effect to that function.

Leonard Hoffman
M H Arden

Lincoln's Inn
20 March 1984