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ASSET REVALUATION AND CURRENT COST ACCOUNTING: UK CORPORATE DISCLOSURE DECISIONS IN 1983

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Accountants have long disputed whether financial statements should report current values and the effects of price changes. Indeed, the two kinds of adjustment are often confused. This study examines the asset revaluation and Current Cost Accounting (CCA) disclosure decisions of UK firms in 1983, using a costly contracting framework. We find the two decisions appear to have been taken for very different reasons and to be largely unrelated, even though the resultant measures overlapped to a non-trivial degree. The two common factors were that revaluers and CCA disclosers both tended to be large and to have revalued in the previous two years. Indebtedness was positively related to revaluation and negatively to CCA disclosure. Current Cost Accounting disclosure was also positively correlated with profitability and fixed asset intensity, whereas revaluation was not.

INTRODUCTION

Countries differ markedly in the extent to which accounting regulations permit or require companies to report on the effects of changing prices in their financial statements. In the UK, the Companies Acts have long permitted companies to make periodic revaluations of fixed assets. The rapid increase in inflation in the 1970s led to demands that the mixed reporting of historical costs and current values be replaced or supplemented by some form of current value or constant price accounting system. This

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debate culminated in the introduction of a Current Cost Accounting (CCA) standard in 1980. The standard was suspended in 1985 and was finally withdrawn in 1988, after which CCA became a purely voluntary matter. In most European countries (the Netherlands being a notable exception) there was little enthusiasm during this period for departures from strict historical cost accounting (HCA), whether in the main statements or as supplementary disclosures. While historical cost continues to serve as the basis of financial reporting in the United States, supplementary disclosures of the effects of price changes were required there too, during the period 1976 to 1986. Given this history, it is perhaps not surprising that the question of choice of valuation basis continues to be a controversial subject amongst accountants in different countries.

The situation prevailing in the UK in the early 1980s regarding fixed asset revaluation and the supplementary disclosure of CCA data provides a valuable setting for studying corporate measurement and disclosure policy choices in an area of accounting which has long been regarded as central to the discipline. Surveys have repeatedly shown that a substantial minority of large UK companies revalue at least some of their fixed assets each and every year. Initial compliance with the CCA standard, SSAP 16 (Accounting Standards Committee [ASC], 1980) by large companies was very high, but quickly tailed off. Prior work has focused either on voluntary CCA disclosures (Thornton, 1986; Wong, 1988; Lemke & Page, 1992) or firms' motives for revaluing assets (Whittred & Chan, 1992; Brown, Izan & Loh, 1992; Cotter & Zimmer, 1995; Gaeremynck & Veugelers, 1999; Lin & Peasnell, 1999). Our study builds on this earlier work to explore the motives underlying the two types of accounting decision in 1983. We show that revaluation and compliance with SSAP 16 were not simply different means of achieving the same ends: some companies revalued assets but did not comply with SSAP 16, and vice versa. This suggests that different costs and benefits were involved.

We found that the revaluation of tangible fixed assets is positively associated with size, prior revaluation and gearing. We also found that compliance with the CCA standard is positively associated with size, the ratio of fixed assets to total assets and return on capital employed, and negatively associated with gearing. In both cases, we attribute the size effect to (a) a desire to avoid political costs and (b) there being economies of scale in financial reporting. Political cost considerations also appear to explain the positive relationship between profitability and CCA compliance. The role of gearing is more complex. The positive relationship between gearing and revaluation appears to be driven by a desire to relax explicit and implicit costs associated with debt financing. In contrast, we attribute the negative relationship between CCA and gearing to political cost considerations: the higher the gearing, the larger is CCA profit and the less different it is to the HCA profit figure. These findings are consistent with the view that the primary purpose of revaluation was to relax borrowing constraints and to