Securities and Obscurities

a case for reform of the law of company accounts

R J Chambers

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The conclusions reached from evidence presented in this book were given in *Accounting, Evaluation and Economic Behavior* (Prentice-Hall, 1966) and 'Second Thoughts on Continuously Contemporary Accounting' (*Abacus*, vol. 6, no. 1, September 1970). Some of the evidence has been used in lectures, articles and books over the past twenty years. A pilot exercise in consolidating the evidence was a paper, 'Evidence for a Market Selling Price Accounting System', given at a symposium in the University of Kansas in May 1970 (published in Robert R Sterling, ed., *Asset Valuation and Income Determination*, Scholars Book Co., Lawrence, Kansas, 1971). To all who have sponsored or published these earlier pieces I am indebted for opportunity and encouragement.

I am grateful to the many companies which over years have supplied their annual reports; and to friends, colleagues and the financial and professional press for examples which would not otherwise have come to my notice. I acknowledge with thanks the assistance of works cited in the List of References, and especially the permissions granted to use copyright material.

To Dorothy Simons I am in debt for mining the mountain of material which yielded the figures digested into such modest space in Chapter 6, and for other countless and varied bits of excavation which are the lot of a research assistant. Thanks to Barbara Brennan, numberless drafts of patchwork manuscript were at last turned into a presentable typescript.

The examples cited in the book are only a fraction of what could have been tendered. The omission of reference to your company, your article or your book is regretted; but enough is enough. Hold me accountable for these and other omissions, errors or obscurities.

RJC

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

PREFACE

Atlantic Acceptance, Reid Murray, Pergamon, Continental Vending, Pacific Acceptance, Westec, BarChris, Yale Express—such companies as these have provided the 'spice' of commercial and financial journalism in the last decade or so. The affairs of these and other companies have been constantly under the notice of company directors, lawyers, accountants and auditors, and the rest of us. Investors and creditors have lost millions through some of them. Auditors and directors of some of them have been sued for millions. Legislators and regulators have been kept constantly on their toes amending the rules, patching up the loopholes in rules and devising new rules to curb the inventiveness of the unfortunate, the astute or the fraudulent officials of companies.

One thing common to all the companies mentioned is that the financial information they published was seriously deficient in quality. This book strikes at that common element. Not because of the failures, losses and litigation that have befallen a relatively small number of companies; rather because prevailing laws and practices under them give rise, almost universally, to distorted representations of the financial results and affairs of companies.

Drawing primarily on examples from the United Kingdom, the United States and Australia, the book shows that the existing practices, even of companies that are well esteemed, are inadequate, uninformative and often obscurantist. But often through no fault of their own. The practices that companies have adopted have generally been permissible under the statutes, regulations and technical rules of accounting of their time. The trouble has been that the laws, regulations and rules have been vague, toothless and often self-contradictory.

The financial information on company affairs which flows to the securities market is the product, principally, of accounting rules. But we do not hold that accountants or their professional associations are alone responsible for the state of the rules. Managers, directors, stock-brokers, financiers, lawyers and others have also played a part, consciously or unwittingly, in bending and stretching the rules. We consider the consequences of this and find it in the interest neither of companies and their officers, nor investors and creditors, nor of the business community at large.

Drawing on other examples from the same countries, on the opinions of analysts, jurists, investigators and others, and on remedial amendments of the statutes, the book establishes a case for the reform of present laws and practices. It proposes a set of rules on financial reporting which would reduce substantially the ignorance and guesswork that now interfere with the exercise of informed judgment by investors on the merits of corporate security investments. The proposals are not a panacea for all commercial ills. But the evidence adduced supports their value to investors and others as protection against misrepresentation, whether innocent or fraudulent.

The value of a well-informed securities market is almost universally acknowledged. But that today's securities markets are well informed is a myth. Uneasiness about the present state of practice is widespread. But the will to reform it is weak and fugitive. Old habits die hard, especially when they serve specific parties at concealed costs to others.

The remedy seems to lie in the hands of the legislators. This book, however, provides evidence of the necessity and direction of reform, no matter who, in the upshot, brings it about.

R J Chambers
University of Sydney
August 1972