TEXT OF ADDRESS BY ROBERT WALKER OF BDO HOGG YOUNG CATHIE (11 MAY 1993)

I have come here today for the following purposes:

1) to acquaint you with two seminal documents produced by the NZ Society of Accountants (NZSA).

2) to identify and discuss the inter relationships between the two, which at first sight are not immediately apparent.

3) the role you as bankers have to play in respect of either or both of the developments arising from the documents.

4) in the event of your inaction the likely impact each may have upon you.

I do not think you would argue with the contention that the activity of banking, in the commercial or business context, is wholly dependent upon the profession of accountancy. That is the information which is the lifeblood of the monitoring activities you carry out. Your task would be impossible if the reporting accountants undertake did not exist; particularly for those of you engaged in the intensive care or credit control function.

It follows that any significant developments or changes in modus operandi within the profession of accountancy is going to have an immediate and possibly profound impact upon yourselves.

You are probably all, at a minimum, dimly aware that financial statements produced by chartered accountants at least are more or less prepared in accordance with the precepts laid down by accounting standards of the NZSA. The history of standards is surprisingly recent, extending back no more than 20 odd years. In NZ there are now 30 standards. Even with this number, I suspect that for the average accountant involved with the average proprietor controlled business "the more" has become "the less" in relation to observance.

To compound matters the Society has become hyperactive in terms of standard setting. The more important development being the proposed Financial Reporting Framework issued in December 1991. This is an immensely complex set of documents the intention of which is to definitively define generally accepted accounting principles (GAAP) and the centrepiece of which is the Conceptual Statement.

There are a number of features of this conceptual framework only a few of which I will draw to your attention. Firstly, and crucially from your perspective, the framework is to apply to what are referred to as general purpose external financial reports. That is financial statements prepared for people who cannot pre–specify exactly what they want. It may follow from this that bankers will be cut adrift from any frame of reference at all and this will force them to specify what they want.

As an aside I would note this position is confused by the latest draft of the Companies Bill, which requires the application of the framework come what may.
This assumes, of course, that the Accounting Standards Review Board is prepared to ratify the body of standards substantially intact.
A second crucial feature is the denunciation of the historical cost convention. The framework states "Under the historical cost system income fails to recognise valuation changes and is accordingly considered an inadequate measure of financial performance."

The alternative is valuation accounting and hence the descent into the morass of the arbitrary in pursuit of "economic" truth to obtain the holy grail of predictive capacity. (I have assumed that CCA is now so discredited as to be beyond resurrection). I can illustrate the consequence of this form of accounting by reference to some examples.

Within your own industry, albeit in the USA, this debate is currently being hotly contested, interestingly the participants being the SEC and the Federal Reserve. The SEC wishes banks to apply valuation techniques to their balance sheets. At certain points you would probably agree that this is a worthy pursuit.

For instance for Treasury Bills (Government Stock) there is a ready and deeply traded market. Pricing is easy and objective. Value can be easily struck No matter, I suppose, that in a thinly traded market such as NZ that liquidation may affect price.

You would probably begin to get a little nervous if we started to apply present value (PV) calculations to loan portfolios in the absence of market information. I suspect you will be running for cover when attention shifted to the liability side of the equation, as the US banks have suggested, and start to apply PV principles here. Banks have a constant and substantial part of funding which generates no expense stream. The present value of such is nought. It follows the permanent pool that is current accounts is miraculously shifted from Deposits by Customers to Capital probably by way of the Profit and Loss. On the face of it extremely bizarre but consistent with the approach.

This may seem extreme but the same problems in different ways will beset you. PV principles do not distinguish between the tangible and the intangible. It is concerned only with future cash flows. Intellectual resources, for example, are as legitimate an asset as a truck, a factory or a building. If I called it Goodwill you would discount it but if Intellectual Assets you would not be so sure.

In short a Pandora's box has been opened. I can see you all running away to suck upon the cashflow security blanket but I submit that this too is bedeviled by problems.
The other fundamental development to which I have made reference is the strategic review of the role of the Society being currently undertaken. What is being proposed is less significant than the fact that it is happening at all. For the record the proposal is to divide the society up into three semi–autonomous bodies representing a basic hierarchy of achievement and maintenance of skill levels. Such to coexist within the Society before the centrifugal forces achieves the same without the Society.

There is I believe a crisis within the so called profession of accountancy, and whilst this is not explicitly acknowledged, it is encapsulated within the financial reporting framework.

The Society has been inadvertently hijacked by the mainstream lunatic fringe, if that is not a contradiction in terms. A tripartite oligarchy consisting of the mega–firms, academics and Society employees have concentrated upon the arcane and the abstruse to the detriment of the simple and the practical.

What accountants should be doing is having more modest aspirations in respect of their capacity to predict the future and they should be more concerned to ensure they validly reflect the past. There is a standard which tells you how to account for a balance within a revaluation reserve upon realisation but none which tells you to reconcile the general ledger to the bank. The priorities are all wrong.

Bankers amongst others must recognise their role as consumers of accounting services and exercise their influence accordingly. This means specifying that they wish to have timely and valid information at the expense of it being relatively simplistic. Further that providers of this information conform to a set of standards objectively set and for performance against these standards to be constantly and impartially measured.

The alternative is for your industry to receive over complicated reports of dubious validity. We will all suffer if this state of affairs prevails.