A FAIRLY TRUE VIEW

By

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The auditing profession has recently been involved in disputes concerning provision for future tax and depreciation of assets.

However, one wonders whether there are grounds for criticism of the auditors themselves in another area, namely the statutory "true and fair view" report attached to company accounts.

What is meant by "true and fair view"? The phrase is rather vague when one tries to define the word "fair". Fair to whom? Auditors represent a company's shareholders and it is their duty to see that the accounts are presented according to the above concept for the benefit of shareholders whilst conforming with the law, the memorandum and articles of association and their contract with the company.

It appears that accounts of some companies hardly justify the statutory report when they do not show the true profits earned in a period. As an example, a leading listed public company recently declared its net profit for the year to 30th June, 1968, as being $1,371,934 which represented an earning rate of 67 cents per ordinary share, after deduction of preference dividends. Before arriving at this figure the company made certain deductions which are shown below with the previous year's figures as a comparison.

At the Annual Meeting the Chairman opened proceedings by volunteering the statement that the

excess charges were, in fact, net profit. To this adjusted figure may then be added the amounts charged to Reserves, for while it is conceded that the Reserve for Plant Replacement and Maintenance may well relate to future expenditure when replacement of assets is more expensive due to inflation and technology, they are really in the nature of appropriations of profit and should be treated as such in the accounts.

Adding back these charges produces a net profit in the vicinity of $2.5 million. Tax provision was $1.3 million which is only 34% of adjusted profit figure but the Company is believed to have benefited from considerable investment allowances on new plant.

When questioned, the Chairman said that the understatement of profit was to iron out fluctuations due to economic conditions, for political reasons and to enable a better result to be shown on increased capital in 1968/69.

One wonders when examining the Directors' statement that "No circumstances have arisen which render adherence to the existing method of valuation of Assets or Liabilities of the Company misleading or inappropriate" whether the state of the company's affairs could not have failed to obtain true value for the shares.

Further, conservatism of this nature can lead to delay in recognising that a company's fortunes are declining due to the possibility that when profits fall directors may tend to become less and less conservative, even though stated profits appear satisfactory. Again this is unfair to shareholders.

Regrettably, the Stock Exchange does not seem to have the power to enforce proper accounting principles and can hardly be expected to override auditors' professional judgment.

It is in this area, and in many others, that a body like the Securities Exchange Commission of the U.S.A. is necessary to police unfair reporting.

Taking another set of accounts, this time those of a listed retailer, the statement by directors attached

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to the accounts showed a net profit of $5,003,184, representing 26.8% on ordinary capital. To most readers this represents the amount available for reserves and dividends, that is, for the benefit of shareholders. However, this is not the case here because an amount of $530,000, more than 10% of stated net profit, was then appropriated to the Employees' Profit Sharing Fund. In other words, the profit available to shareholders was really $4,473,184, being 24% on ordinary capital, which is markedly lower than stated by the directors. While it is conceded that the amount available for Employees' Profit Sharing Fund can only be ascertained after the net profit has been struck, and in this particular case the auditors have shown it clearly in the accounts, as far as shareholders are concerned this is in the nature of a bonus to employees and as such is a charge against profits before reaching the final net profit figure, which is of paramount interest to shareholders.

There are a number of instances of companies displaying undue conservatism in their accounts; some of these have recently found themselves targets for takeover bids and have had to take evasive steps to thwart would-be suitors.

The writer concludes that there should be more action taken by influential bodies to compel companies transgressing the principles of the type outlined above to show “true” profits rather than “desired” profits.

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fall, but by its action in May and June it clearly suggested that all was not well and that the investor should be prepared for the index to change direction. At this time the wise move would have been to sell those shares which had the greatest downside risk, or which had shown the greatest increases in the earlier part of the year.

During July and August the A-D Line continued on its downward trend despite several rallies along the way. The fluctuating movements, indicating lack of stability at no time suggested the market trend would change. The sharp fall in the index in September was not surprising to an observer of the A-D Line's movement throughout that month. The next test of the A-D Line theory will come over the next few months as investors look for a sign that the market is strengthening and the balance of price rises and falls again changes in favour of the rises.

In conclusion from the experience of the A-D Line and 50 Leader Index relationship displayed over the April-September period it appears that the line is equally suited to the Australian markets as the U.S. markets in helping the investor frame his investment policies.

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