The September 1974 issue of this journal carried an article on this subject by Mr. H.D.N. Reid. With great respect to Mr. Reid, I state that I found his presentation of the subject very impressive.

Mr. Reid's article makes reference to developments in the United Kingdom which show that increasing recognition is being given to the need to get away from the "stable money convention" which has characterised accountancy since things like balance sheets and profit and loss statements were first developed. That article records also his awareness that the two accountancy bodies in Australia (The Institute of Chartered Accountants in Australia and Australian Society of Accountants) would be making a pronouncement similar to the pronouncements made in the United Kingdom. The Australian pronouncement was duly made in early December 1974. I am in no doubt that everyone who carries responsibilities for the analysing or management of securities will read it, absorb it and, as a result, undergo some permanent change of life. It is inevitable that the proposed new set of rules for measurement of profit, assets and proprietors' funds (after a few refinements to be imposed by practical experience) will, in the course of the next one, two or three years, completely replace the old rules.

There is but one part of Mr. Reid's treatment of the subject which does not gain my support and my disagreement is simply a matter of emphasis. Early in his article (page 2) he says that "the two most important causes of profits overstatement (under the old rules) are (1) under-depreciation of fixed assets and (2) stock appreciation". I am quite sure that those two factors are not the two most important causes; they are less than the "errors of absence" from traditional profit and loss computations of:

(a) The losses suffered through the impact of inflation on monetary assets (cash, trade debtors, loan debtors, fixed-interest investments and the like);

(b) The profits earned through the impact of inflation on liabilities (of every sort).

It is as well that I make a few observations in support of that submission.

Firstly, the depreciation charge:

1. It is a writing down year by year of the amount recorded in the books for plant and buildings.

2. In very few businesses is the depreciation charge on buildings a major item. It is the depreciation of plant which attracts the attention of the reformists.

3. Relatively, plant is an item of very little significance indeed in -

   Banks
   Finance companies
   Wholesalers and importers
   Retailers
   All primary industries

4. It is only in manufacturing and transport that plant is a very significant proportion of total assets. The total wealth of businesses in manufacturing and transport is surely much less than the total wealth involved in the five classes of businesses enumerated in 3.

5. In the cases of stock and debtors, the whole of the wealth involved at the
beginning of the year is exposed to inflation until the end of the year. In other words, every dollar shown in the measurement of the values given to stock and debtors at the end of the year is a weaker dollar than any of the dollars used as measuring units at the end of the previous year. In contrast, it is only about 10% or 12% of the dollars used to record the "value" of plant at the beginning of the year which gets written out as depreciation for the year and, therefore, gets replaced by weaker dollars.

I am well aware that, in the development of this problem of accounting for inflation, it has been depreciation which has most readily given comprehension of the need for traditional accounting procedures to be replaced. It became common-place knowledge with most businessmen and most sharebrokers. However, their understanding, by being inadequate, has been wrong. Their comprehension has to be widened.

Secondly, stock appreciation:

1. Stock is a matter of no consequence at all in -
   - Trading banks
   - Savings banks
   - Merchant banks
   - Life offices
   - Finance companies (except equipment held for leasing)
   - Building societies
   - Unit trusts and mutual funds
   - Superannuation funds
   - Service organisations (professional offices, advertising agencies, public relations consultants)

2. Relatively, stock is a matter of very little consequence in -
   - All primary industries
   - Transport organisations
   - Trust settlements

3. The organisations listed and (1) and (2) represent a very substantial part of the nation's total complex of business and finance. Their gross assets are, so I am inclined to judge, greater than the combined gross assets of all manufacturers, wholesalers and retailers and, even in the latter, stocks are far from being the major asset.

It is when we come to assess the deficiencies in traditional financial reporting on monetary assets and on liabilities that we encounter dramatic figures - dramatic losses that rate no mention in annual accounts, dramatic profits that, by being absent, speak so compellingly to those of us who have been initiated into the proposed new system of accounting.

I view it as a sad commentary on the financial system under which we have spent our lives that:

(a) All of us who earn our livings in relatively important positions have had a clear awareness for a long time past that every fixed-interest investment has yielded a negative return to the investor in most years of the last 30 after regard is had to the influences of inflation and tax.

(b) Not one of us has succeeded in having even one dollar of the losses so incurred by creditors (as lenders) reported in financial accounts.

(c) Not one of us has succeeded in having even one dollar of the resulting profits earned by debtors (as borrowers) reported in financial accounts.
(d) Very few of us have recorded any awareness we have of the probability that there is no way out of our present economic problems unless it includes complete protection to the purchasing power of wealth in the form of money.

(e) That protection is unlikely to be forthcoming unless the desire for it is nurtured by the regular financial reporting of all losses incurred and all the profits earned as a result of the protection being absent.

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INFLATION AND PUBLIC SERVICE PENSIONS

The case against indexation of public service pensions has been stated by Michael Pilch in the U.K. publication, "The Director", of September 1974. It is contained in a series of articles on inflation and pension funds, and his argument is equally relevant to the situation in Australia:

"Following the Pensions Increases Act of 1971, most occupational pensions in the public sector enjoy statutory protection against rises in the cost of living. The Conservative Government of the day made political capital out of this decision, portraying themselves as 'good' employers who were setting a lead for others to follow. From the point of view of members of the affected schemes inflation-proofing is obviously very desirable, but the wider issue of the public interest was barely debated at the time the legislation went through parliament.

"The trouble is that any protection against inflation given to a particular sector of the community tends to worsen the position of the rest.

"If as a result of rising prices, higher pensions have to be paid to retired civil servants, the cost must be borne by taxpayers - who may be earning less than the people they are required to subsidise. There must be doubts about the wisdom of insulating a particular group of pensioner at public expense against the consequences of inflation - especially bearing in mind that some public servants share responsibility for decisions which may have a material bearing on the rate of inflation in the future."

The author went on to refer to private sector pensions in relation to indexation:

"Unlimited guarantees associated with index-linking may be feasible for the State or for organisations which have the backing of the public purse, but any private employer putting his name to such a pledge may be undertaking more than he can ultimately perform. Government policy is the major determinant of inflation and any attempt to shift responsibility for the consequences to other shoulders ought to be resisted - on social, as well as economic grounds."

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