It is my task to talk to you tonight on the subject of 'Needs of users - an analyst's view'. In doing so I will perhaps give more weight to the need of analysts than to those of other users but I do so in the general belief that the needs of other users for accounting information about the corporate sector run closely parallel to the needs of analysts, although naturally with variations in emphasis and in detail. I should also say that the views expressed are mainly my own and do not necessarily reflect those of the Securities Institute.

I am reminded of a remark by Oliver Cromwell who said (in 1641) 'I can tell you, Sirs, what I would not have: tho' I cannot, what I would'. I can understand what he said (in 1641) 'I can tell you, tho' I cannot, what I would'.

Not whole facetiously, I think that the first need of investment analysts is to have plenty of companies left to invest in. Not whole facetiously, I think that the first need of investment analysts is to have plenty of companies left to invest in. With this caveat let me proceed.

I don't suppose that this audience is likely to dispute that in a commercial community such as ours the participants have a need for meaningful accounting information, and that it should be meaningful to and its principles followed by not only direct financial participants such as investors, lenders, customers and employees, but also by less direct participants such as price regulatory bodies, taxation authorities and so on.

The particular concern of the investment analyst derives from his function as one of the members of this community concerned with the pricing and allocation of resources. It is fair to say that by far the great number of analysts fulfill this function by concerning themselves with the evaluation of securities, and I think it might be profitable to briefly identify what analysts actually do in a day to day sense and to indicate some of the information that they need to function effectively.

As I see it the analyst occupies himself in three major ways. Although they are all related to the same objective and inter-related with each other, it is conceptually useful to consider them separately.

The first function may be termed the measurement of corporate performance. In a short term sense this may be no more than a quick analysis of a company's interim or preliminary final profit result. As profit announcements are probably the most important piece of price sensitive information that a company publishes, and recognising that analysts are, or should be, concerned with the efficient functioning of the securities markets, we need a system that tells us clearly, unequivocally and reasonably quickly what companies' performance has been. We're certainly not getting that now. The key word here is comparability both as between prior periods and as between other organisations.

The Sandilands Committee seems to think that this can be achieved without a constant value unit of account but I personally feel that this feature would be a most desirable one. The present method of valuation as between time periods, and in addition a reasonably consistent basis of valuation as between companies, I recognise that it is impractical to expect perfection in this latter regard. In a less immediate sense evaluation of results enables analysts to make judgements on the quality of management - its past decisions and present performance. A most important component of this will be an assessment of a company's return on funds employed - its absolute level as well as any change - and also of the course the return on shareholders funds, which derives from the relationship between a company's operating return and the financial structure under which it chooses to function. Whilst acknowledging that all improvements in the position of equity, in real terms, can be construed as 'profit', for this purpose I think we do need to be able to sort out as far as possible those that derive from capability and those that derive from circumstance. I recognise that in many cases this clear differentiation between operating profit and holding gains will not be possible, but that does not mean that it should not be attempted.

The second function of the analyst is to concern himself with corporate liquidity and solvency and this will also be a concern of many other users. I think that the main point here is that notwithstanding money's acknowledged deficiencies as a unit of account it is still - by definition - the medium of exchange. The bills have still got to be paid with it. I don't think that analysts needs in this area will be enormously different to those that exist at present, which are that information is needed to judge a company's ability to meet its obligations as they fall due. In this respect I think an expanded source and application of funds statement for the year just passed is important to give a clearer understanding of a company's internal workings, coupled to a more detailed debt repayment schedule which should also be extended to include non-financial corporations. In addition an indication of what new investment is contemplated seems desirable, and there may even be a case for cash-flow forecasts.

The third and possibly most important function of the investment analyst is to try and look into the future. If securities prices are indeed what the theorists say they are, that is the present value of the expected flow of future returns, then what investment analysis is all about is trying to determine what those future returns are likely to be, and deciding whether the implied rate of discount is an appropriate one having regard to risk and so on. However, to quote from Denis Weaver's useful book 'Investment
Analysis: "Forecasting is a hazardous task, and those who
practise it must become inured to a lower level of success
than would be appropriate in other occupations." I venture
to suggest that here in Australia it is even more hazardous
than in some other countries, and the major reason for this
is the low level of corporate disclosure requirements. In
order to be able to do our job as forecasters properly we
need a great deal more information as to how companies
arrived at their current positions. This is not because we
want merely to extrapolate from past data series, but
because an understanding of the variables that influenced
a company's present position, financially speaking, is of
great benefit in estimating where it is likely to go next.

I appreciate that a part of what I have been saying
does not, strictly speaking, relate to accounting but rather
to disclosure, but the two subjects are closely associated.
If we as analysts cannot do our job properly in the context
of the existing accounting system because of inadequate
disclosure, there is a danger that we could be even worse
off under any new system. In this context I think that
fairly detailed reconciliation statements in the first year
or two of the operation of any new system will be essen-
tial for the understanding of individual accounts, and will
also have a useful role in educating existing practitioners
in the principles and practice of the new system.

Not being an accountant I don't propose to try and
offer a detailed solution as to how any new accounting
system can meet analysts needs, but I think it may be
profitable to indicate my interpretation of how analysts
are thinking in some areas. Analysts are concerned with
basing their judgements on information which is tolerably
close to what may be called economic reality so I think
it will be realised that a simple Current Purchasing Power
approach is unlikely to appeal to them in principle. CPP
perpetuates the fundamental failure of historical cost
accounting, which is that - quite apart from the distortion
it produces in periods of high inflation - it has been
unable to deal with relative changes in price levels on a
continuous basis, but rather has had to make do with
occasional 'one-off' adjustments. I wouldn't like to say
what effect this has had on the allocation of new resources
but we can all think of cases where it has concealed and
quite possibly caused the inefficient use of existing resour-
ces.

If we reject a simple CPP approach we are left with
the choice of a number of methods of making specific
valuations of assets; in other words a current value ap-
proach. I am inclined to the view that in this area we have
a choice between two approaches that are likely to be
regarded by users at large as realistic possibilities: The
Current Value - Proprietorship and the Current Value -
Entity schools of thought. Mr. Ronald Mutton has defined
the difference between the two rather neatly, I think. I
quote "CVA (Proprietorship) means the Current Value
Accounting method which claims that differences between
general index adjusted current value adjustments belong
to the profit and loss account," whereas "CVA (Entity)
means the Current Value Accounting method which
claims that those differences have no influence on
profit or loss and belong directly to 'capital'."

The argument for the entity school is attractive,
and has been supported by the Society of Investment
Analysts in the U.K., and it certainly seems likely to be
attractive to company managements. However, I think
that it is reasonable for analysts to argue that it is desir-
able for the corporate sector as a whole to maintain intact
its physical capital, but as analysts it is a part of our func-
tion to try and identify and profit from relative changes in
prices as between one component and another. Analysts
are concerned with and represent actual or potential
investors. These investors are interested in maximising
their returns and wealth consistent with what they regard
as an acceptable degree of risk. Their relationship with a
company is normally quite divorced from the management
of the company, and unlike the management, they are in
a much more flexible position as regards their freedom to
invest or disinvest. For these reasons I believe that it is
more consistent for analysts to support the proprietors
view in the case of individual companies.

The entity approach can effectively be equated with
the replacement cost approach, and analysts may have one
or two other reservations about this, which I don't have
time to discuss at present. Having said that I do recognise
that if, like Sandilands we follow Professor Bonbright in
defining the value of an asset to its owner as being 'ident-
ical' in amount with the adverse value of the entire loss,
direct and indirect, that the owner might expect to suffer
if he were to be deprived of the Property, then in many
cases replacement cost, or written down replacement cost,
will be an appropriate method of valuation.

You will have observed that I have up to now care-
fully avoided the question of gains or losses on monetary
items. Sandilands dodged the issue but pointed out that
under its system of valuation such gains or losses do accrue
to equity even though they are not separately identified,
and the same is true of other systems. Speaking personally,
I feel that there is a good deal of logic in the approach
that says 'we know that in times of inflation lenders lose
real wealth when their net interest return is less than the
rate of inflation, so let us identify who is gaining it'. I
cannot see that it can be terribly good for the system as
a whole if the holders of equity consistently 'rip-off' the
holders of debt, nor can it be terribly conducive to manag-
erial prudence in respect of gearing. In addition if high
interest rates are in part a compensation for capital loss
then to that extent income taxes on interest are in fact
taxes on wealth held in this form. I think that identifying
some of these anomalies will be an important first step
towards correcting them.

To summarise briefly then, the needs of analysts as
users may be said to be - and I make no apology for the
contrived alliteration -:

1. Continued health of the corporate sector
2. Comparability of results
3. Constant value unit of account
4. Capability and circumstance to separate
   the gains to equity
5. Corporate disclosure; more of it
6. Current value (proprietorship) approach
7. Correction for monetary gains or losses

And perhaps I should add to that list Comprehensibility.

I defer, happily, to the accountants on the panel to provide
the catholicon which will meet these needs.