

**Submission to the Joint Parliamentary Committee on Accounts and Audit**  
*Review of Independent Auditing by Registered Company Auditors*

An issue the Committee may wish to consider in evaluating the quality of audits of the financial statements of companies is the quality of the measurement rules applied in preparing financial statements. Accounting standards provide those rules.

My contention is that the standards themselves lack a unifying theme, and are inconsistent. Hence, the proper application of those standards does not guarantee consistent measurement of periodic profit over time for the same company, nor do they guarantee consistent measurement of periodic profit for the same period for different companies.

The realisation concept (the idea that there is no revenue, the source of profit, without a sale to an external entity of goods or services for cash, or a right to cash, in an executed sales contract) has been departed from in several standards (e.g., AASB 1023, AASB 1037). In my opinion all periodic profit measurement for Australian companies should be based on realisation; and, on the assumption that the Australian dollar continues to be accepted for settlement of local debts without their indexation, that the cost of operations should be measured at the actual costs incurred. I refer to the related concept of profit as “monetary profit” to indicate that it is derived from the actual cash flows (market transactions based on contracts). Capital of the company is similarly regarded as money share capital - the actual money amount paid in by shareholders in accordance with the contract with them on subscription for the shares. The overall system can be described as a “number-of-dollars” measurement system, or simply referred to as the monetary model. Consistently applied, this system has been described as historical cost accounting. However, with many departures now permitted by accounting standards from the cost basis, that description is no longer relevant. Furthermore, by emphasising one aspect - cost - it was too narrow to serve as an accurate description of what was being measured.

The monetary model, or “number-of-dollars” measurement system, provides information relevant to the two information needs common to all shareholders of stewardship by the directors for the money share capital contributed to the company, and for disclosing financial information confirming that dividends paid or proposed will be paid out of earned monetary profits - a genuine surplus in excess of the paid in money capital, thereby ensuring that dividend payments are not a fraud on creditors.

These two information needs, however, are not the only ones for which shareholders require financial information. In addition, shareholders wish to receive financial information indicating the liquid funds available to the company for settlement of its current debts, and also in respect of its long term solvency. Calculation of asset backing per share measured in the current market values of the company’s exchangeable assets is an example of another information need requiring disclosure of the current market values (where available) of the company’s exchangeable assets. Such a statement could be described as a “statement of financial position” - a term preferred in AASB 1040 over the traditional balance sheet. (Yet the latter term is the more accurate for the balance sheet of the monetary model.)

In addition, some standards (e.g., AASB 1016) allow alternative treatments which may be reversed, in effect increasing the discretion available to directors in determining profit for the period.