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978-0-521-82684-6 - Corporate Collapse: Accounting, Regulatory and Ethical Failure, Second Edition
Frank Clarke, Graeme Dean and Kyle Oliver
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Praise for the first edition:

'A provocative and timely publication, this book will stimulate public debate about national accounting issues and deserves thorough study by managers, regulators, accountants, investors and politicians.'
J.G. Service, Chairman of the Advance Bank

'This book makes a valuable contribution to the history of accounting practice and of corporate regulation in Australia. Many of the lessons from corporate failures have not previously been identified, let alone learned.'
Professor Robert Walker, University of New South Wales

'A very dismal story … one of the most important studies in corporate accounting behaviour undertaken in many years … required reading for all academic accountants, senior students, professional accountants and regulators.'
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Corporate Collapse

ACCOUNTING, REGULATORY AND ETHICAL FAILURE

This revised edition of Clarke, Dean and Oliver's provocative book tells why accounting has failed to deliver the truth about a company's state of affairs or to give warning of its drift towards failure. By studying a number of well-known cases of corporate collapse from the 1960s to the present day, the authors observe that little has changed. They balance broad interpretations and recommendations for reform with fine detail of particular cases, insightful analysis of contemporary practices and dissection of the pervading commercial rhetoric. This revised edition includes a detailed examination of HIH and other case vignettes, Patrick/MUA, Ansett, One.Tel and Enron and shows that the cult of the individual in media coverage has masked serious endemic problems in the system of reporting financial information. *Corporate Collapse* is essential reading for professional accountants and auditors, company directors and managers, regulators, corporate lawyers, investors and everyone aspiring to join their ranks.

Frank Clarke is Emeritus Professor of Accounting at the University of Newcastle.

Graeme Dean is Professor and Head of Accounting at The University of Sydney.

Kyle Oliver is a Lecturer at the School of Law, University of Western Sydney.

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Accounting, Regulatory and Ethical Failure

Second Edition

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University of Newcastle

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University of Sydney

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Dramatis personae

Adler, Rodney	Chairman of FAI and non-executive Director of HIH.
Adsteam	Adsteam conglomerate with the flagship company, The Adelaide Steamship Co. Limited. John Spalvins was at its helm from 1977 to 1990. It was perceived as a 1980s corporate 'high-flier'.
Ansett	Ansett Transport Industries Ltd, a major transport company and 49 per cent shareholder in ASL, was headed by Sir Reginald Ansett. In 1978, Ansett declined to finance further ASL's operations, thereby precipitating its ultimate collapse.
ASL	Associated Securities Limited (ASL group).
BCH	Bond Corp (or Bond Corporation Holdings Limited), renamed in 1993 Southern Equities Corporation Limited, was one of Australia's largest and most internationally known entrepreneurial companies of the 1980s. Alan Bond was its founder and chairman from 1967 to 1991.
Bosch, Henry	Chairman of the NCSC (1985–1990) and major spokesperson on corporate governance in the 1990s. He was extremely critical of the accounting practices of Westmex and Bond Corporation.
Brierley, Sir Ron A takeover 'whiz kid'	Founder of Industrial Equity Limited and a major antipodean investor from the 1970s to the 1990s. Brierley proved to be a major factor in the downfall of Adsteam, especially his fatal 'consolidated' account of the conglomerate's state of affairs.
Cambridge	Cambridge Credit Corporation Limited (Cambridge group), run by R.E.M. (Mort) Hutcheson.
Chambers, Ray	Foundation Professor of Accounting at The University of Sydney. His iconclastic reforms included the development of the method of Continuously Contemporary Accounting (CoCoA); entailing a completely integrated mark-to-market system.
Dallhold	Dallhold Investments Proprietary Limited (Alan Bond's family company).

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Enron	Once the seventh largest publicly-listed entity in the USA, it suddenly crashed to become one of the USA's largest bankruptcies. Its Chairman, Kennett Lay, presided over a period of intense scrutiny of its accounting practices culminating in the demise of Enron's audit firm, Andersen (one of the then 'Big Five' accounting firms), due to its alleged document shredding at Enron.
H.G. Palmer	H.G. Palmer (Consolidated) Limited, named after its founder Herbie Palmer. Palmer refers to H.G. Palmer (Consolidated) Limited (Palmer group).
HIH	HIH was one of Australia's largest insurance companies, one of its largest liquidations and now the catalyst for the first mooted litigation against the federal government and its prudential regulator, APRA. Its founder and Chairman was Ray Williams, a leading Sydney philanthropist before HIH's collapse early in 2001.
HIHRC	HIH Royal Commission was appointed in May 2001 with Justice Neville Owen as its Royal Commissioner. Hearings were held throughout 2001 and 2002 generating nearly 2000 pages of transcript and several million pages of submissions and images. A report is expected in April, 2003.
Insull, Samuel	Insull Utility Investments Inc., a major 1920s US utility conglomerate which took its name from its founder, Samuel Insull.
Kreuger, Ivar	Kreuger and Toll Inc., a major 1920s multinational match company headed by Ivar Kreuger.
Monet, Claude	Impressionist painter of *La Promenade*, the acquisition and sale of which by Bond Corporation was central to the gaoling of Alan Bond in 1996 on conspiracy to defraud charges.
Maxwell, Robert	British newspaper and communications baron throughout the 1970s and 1980s, who was found drowned in 1991 thereby sparking a series of investigations, a mountain of corporate debt and many unanswered questions about his financial empire. Maxwell's mysterious death is now creating speculation that his death was not related to his financial dealings, but was more likely related to political and espionage intrigue.
Minsec	Mineral Securities of Australia Limited, or MSAL, refers to a loose collection of companies known as the Minsec group managed by Ken McMahon and Tom Nestel in the late 1960s and early 1970s.
Murphy, Peter (QC)	Investigator appointed by the Victorian government to inquire into the affairs of Stanhill Development Finance Limited and related companies.

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Murray, B.L. & B.J. Shaw (QCs)	Investigators appointed by the Victorian government to inquire into the affairs of the Reid Murray Holdings group.
Reid Murray	RMH, or Reid Murray Holdings Limited (Reid Murray group), headed by Ossie O'Grady.
One.Tel	One of Australia's most notorious telcos. It had a meteoric rise and fall in the late 1990s and early 2000s. Its founders, Jodee Rich and Brad Keeling, and some of its 'financiers', Lachlan Murdoch and James Packer, were described by journalist Paul Barry as the 'Rich Kids'.
RMA	Reid Murray Acceptance Limited, formed to act as a corporate 'banker' for RMH.
Rothwells	Western Australia-based merchant bank headed by the colourful financier Laurie Connell. Rothwells was pejoratively described as a 'lender of last resort' for high-risk ventures. Rothwells' and Connell's activities were scrutinised during the WA Royal Commission into WA Inc.
Rowland, Roland (*Tiny*)	Founder of the multinational Lonrho and a crucial player in the final downfall of Bond Corporation, especially the world-wide distribution in late 1988 of the notorious 'Financial Analysis' document detailing Bond Corporation's 'insolvent' state of affairs.
Royal Mail	Royal Mail group, headed by the Royal Mail Steam Packet Company Ltd – the world's largest 1920s UK ocean liner group run by the former Governor of the City of London, Lord Kylsant.
Stanhill	Stanhill Proprietary Ltd, family company of Stanley Korman, founder of the SDF group including SCL (Stanhill Consolidated Limited), SDF (Stanhill Development Finance Limited), Chevron (Chevron Limited) and SD Pty Ltd (Stanhill Development Proprietary Limited).
Van Gogh, Vincent	Impressionist painter of *Irises*, which was acquired in the mid-1980s by the Bond Corporation group.
Westmex	Westmex Limited was a 1980s conglomerate 'high-flier' headed by Russell Goward during its brief rise and fall from 1986 to 1990.
Whiz kids	Phrase coined to describe those takeover wizards of the securities market who engaged in conglomerate takeovers in the mid-1960s and more conventional acquisitions in the early 1970s. They included Sir Ronald Brierley and Alexander Barton in Australia, Harold Geneen of ITT fame and Sir James Goldsmith (Britain). Subsequently applied to some Australian 1980s 'high-fliers', including Russell Goward.
Williams, Ray	One time Deputy Chairman and Chief Executive Officer of HIH.

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AARF	Australian Accounting Research Foundation, formed in 1966 as part of the profession's response to the spate of 1960s' corporate collapses.
AAS	Australian Accounting Standards, which have had the force of law under Australia's Corporations Law since 1992.
AASB	Australian Accounting Standards Board, the major standards-setting body since 1992.
AFC	Australian Finance Conference.
AICPA	American Institute of Certified Public Accountants.
APB	Accounting Principles Board (United States Accounting Principles-setting body, 1959–1971).
APRA	Australian prudential regulator since 1998. It regulates activities of the banks and other financial intermediaries.
ASA	Australian Society of Accountants (predecessor body of the ASCPA).
ASC	Australian Securities Commission, the successor to the NCSC as Australia's national corporate regulator (1991–1998). Replaced by ASIC.
ASIC	Australian Securities and Investments Commission, the successor to the ASC as Australia's national corporate regulator (1998–).
ASCPA	Australian Society of Certified Practising Accountants; was replaced in the late 1990s by CPA Australia. Together with the ICAA, this body represents the public face of Australia's accounting profession.
ASX	Australian Stock Exchange Ltd, formed in 1990 from an amalgamation of Australia's state Stock Exchanges.
CEO	Chief Executive Officer.
CFO	Chief Financial Officer.
CLERP 9	Company Law and Economic Reform Programme No 9.
FASB	Financial Accounting Standards Board (United States Accounting Standards-setting body, 1972–).
Financial Review	*Australian Financial Review.*
FITB	Future income tax benefit.
FRCLSE	Financial Reporting Council of the London Stock Exchange (1990–).

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FRC	Australia's Financial Reporting Council. Formed in 2001, it has general Government oversight responsibility for the governance of corporate financial reporting practices under the Corporations Act.
GAAP	Generally Accepted Accounting Principles.
IASC	International Accounting Standards Committee (International Accounting Standards-setting body, 1973–2001).
ISC	Insurance Supervisory Commission (–1998). It was replaced by APRA in 1998.
IASB	International Accounting Standards Board. Formed in 2001, it has carriage for the setting of International Financial Reporting Standards.
ICAA	The Institute of Chartered Accountants in Australia (1928–).
ICAEW	The Institute of Chartered Accountants in England and Wales (1880–).
IFRS	International Financial Reporting Standards set by the IASB. Previously IAS.
ISOYD	Inverse sum of the years' digits depreciation method.
JCPAA	Joint Committee on Public Accounts and Audit – a joint committee of Australia's federal parliament.
Mark-to-market accounting	The process of stating all non-monetary assets at their current market prices.
Mark-to-Model	A method of mark-to-market accounting used by Enron. The model was used by Enron, drawing on discounting procedures, to arrive at a 'synthetic' market price for Enron's asset holdings of energy (and other) derivatives.
NCSC	National Companies and Securities Commission – national corporate regulatory body (1981–1990). Replaced by the ASC.
NPV	Net present value.
POB	Public Oversight Board (part of the SEC Practice Section of the AICPA).
Ramsay Report	An Australian federal government initiated report finalised in late 2001 by Harold Ford, Professor of Law at The University of Melbourne, Ian Ramsay, about issues related to auditor independence.
Rule of 78	A recognised arbitrary method of apportioning interest on term contracts, such as hire purchase finance.
SEC	Securities Exchange Commission, formed in the United States in 1933 during the Depression as part of America's 'New Deal'. It took many functions previously held by the Federal Trade Commission.
Tax Effect Accounting	A method of accounting for income taxes.
UIG	Urgent Issues Group, formed at the end of 1994 with the aim of 'providing timely guidance on urgent financial reporting issues'.

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Foreword

The second edition of this book appears six years after the first. The context is the end of an 18-year bull market – one of the longest during the twentieth century, with the emergence and passing of the dot.com hype, and significant turbulence and loss of confidence on corporate financial markets generally, and with corporate governance in particular. The Long Term Capital Market rise and demise in 1998, the crash of many dot.coms in early 2000, as well as the more recent collapses of several large, 'old' and 'new' economy companies, like HIH, Harris Scarfe, One.Tel, Pasminco and Centaur in Australia, Enron and WorldCom and Adelphia Communications in the US, characterise the setting.

This revised edition is going to print in circumstances that contradict what many had imagined might flow from the insights and developments in purported efficient markets and rational pricing theories, and the hype associated with the Internet's ability to create an information superhighway. Some commentators are claiming that the major financial markets are experiencing unprecedented turbulence of an enduring nature. Certainly the actions of those charged with mutual fund and pension investments have resulted in a major retreat from investing in the stock market, and moving into cash and other perceived 'defensive investments'. This has caused substantial declines in, and increased volatility of, stock market indices worldwide. The resulting reduced collateral has placed pressure on those who had borrowed to sustain their share investments. Concerns exist that the declines in the stock market could spill over into the real economy and that the oft-disputed US 'speculative bubble' had burst. This would inevitably affect other stock markets, like Australia's. Such 'effects' rebuke the myth that those market declines produce only 'paper losses'.

World capital markets' participants, academics and regulators alike, eulogised the benefits of the newly-coined 'new economy', and associated new methods of valuing companies as P/E multiples reached peaks seen ominously

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only during the previous twentieth century 'market bubbles' of 1929, 1969 and 1987. As with those previous booms, an 'irrational exuberance', remarked upon in 1996 by Federal Reserve Chair Alan Greenspan, appeared to have been partly responsible for what, in respect of the 1920s boom period, John Kenneth Galbraith described as an 'inventory of undiscovered embezzlement'.

Those 'in the know' had declared that the end of the second millennium would prove to be different, that this was no financial 'bubble'. It was suggested that technological developments, the impact of the baby boomers and the information revolution had created new ways of creating and measuring sustainable shareholder value. Recurrent, tell-tale symptoms of macro financial problems linked to excessive merger and acquisition activity, often heavily debt financed, have been ignored; remarkably, just as they had been in episodes like the 1600s Tulipmania, the 1700s South Sea Bubble, the 19th century Railway manias and the 1920s investment trust boom presaging the 1929 Great Depression.

But for many, events on capital markets in April/May 2000 portending the demise of the dot.com phenomenon were to change that way of thinking. Share price indices for technology stocks tumbled 40–60% across various capital markets, as billions of dollars were wiped off corporate market capitalisations, especially off those eulogised new economy companies. Dot.coms became part of the tech-wreck flotsam as they either went into liquidation or were taken over by the surviving 'old economy' companies. Within a year or two the financial meltdown in the main stock markets would affect many old economy, merger-driven conglomerates, like Enron, Vivendi, WorldCom, AOL Time Warner, Waste Management, Global Crossing, and others.

As before, few see the similarities between the latest crises and those of preceding generations.

The latest boom/bust era has generated new labels – rather than conglomerates and creative accounting, we had 'new economy companies', 'pro forma' or 'aggressive' earnings, 'earnings management' as the new mantras. But, from an accounting and financial management perspective, it was merely more of the same. More creative accounting and an inadequately informed capital market combined to produce a lack of investor confidence in the market and, predictably, the bears took over from the bulls.

The 'old' cries for better quality, more transparent accounting re-emerged. Clearly these events demonstrated that there is 'nothing new under the sun'. Disputed claims that some countries had better accounting standards, a *principles-based* rather than a *Standards-based* system, have enjoyed popular currency. Much of this was without foundation and ill-informed.

Our first edition provided evidence that perceived poor quality financial reporting was a major factor in the continued criticism of accounting and

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auditing practices following *large*, often *unexpected* corporate collapses. Responses to our first edition and to what is occurring at present indicate that our emphasis on the *unexpected* nature of the collapses and the implications for accounting have not been sufficiently heeded. Company failures *per se* are not on our radar as much as how accounting data mask any trends that would indicate impending failure.

Against that background we advocate a complete mark-to-market system of accounting and a return to the professional ethos that published accounts should satisfy the 'true and fair view' criterion as a 'first order' requirement. We take heart that six years on some of the larger accounting firms, individual members of the profession, lawyers, journalists and others are also advocating this. In contrast neither regulators nor governments seem to be convinced – seemingly more determined to invoke a regime of International Financial Reporting Standards. Unless the move to full mark-to-market occurs we predict that auditors will continue to be on a 'mission impossible' and that regulators, directors and auditors will continue to be exposed to the 'time-bomb' in verified published accounts that are based on a primarily capitalisation-of-expenditure model. Further, that, by failing as professionals to get their house in order, accountants face losing that respect associated with a mature profession. They risk losing their professional status. At a macro level, the impact will be disastrous as trust in the disclosure regime, characterised by (*inter alia*) Federal Reserve Chair Alan Greenspan's observations in a 2002 US Senate Committee address as 'essential' for an effective market system, will continue to be undermined.

New millennium crises such as those at HIH in Australia and Enron in the United States have seen those first edition prophecies fulfilled. As with the demise of the large accounting firm Lowenthal in the early 1990s, the Andersen firm did not survive the brouhaha and litigation emerging from those recent collapses and the revealed irregularities in and inherent ineptitude of accounting and auditing practices. The profession suffers the ignominy of the almost unbelievable daily national and international media headlines lamenting the corporate 'earnings malaise' and 'accounting irregularities' in the reported audited results of major corporations, prompting massive write downs and other adjustments later. Almost daily, press headlines repeat phrases similar to those reported in the first edition with respect to previous *unexpected* collapses: 'Accounting in crisis', 'Hey presto! The magical world of creative accounting', 'Articles of faith. How investors got taken by the false profits', 'Lies, damn lies and annual reports', 'Hocus pocus accounting', 'Pick a number, any number,' 'Abracadabra accounting', 'Nasdaq firms' pro-forma alchemy', 'Off-balance-sheet land is where the death spirals lurk', 'Auditors called to account', '"System is broken": world needs tougher rules for accounting'.

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Governments' proposed reactions are misguided. Current events reinforce our claims in the first edition that the prevailing accounting practices permit social injustices through the existence of an ill-informed capital market. The trust that arises from a properly informed market continues to be undermined by poor quality accounting. A prius is that the previous call for a mark-to-market accounting system be heeded.

Our aim from this account is to improve the public perception of members of the profession and to restore public confidence generally through the provision of a well-informed capital market.

While our first edition's 'hope that the observations which follow will jolt accountants and company regulators into long overdue action' was not realised, we remain forever optimistic.

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Preface

In the first edition we observed that, over more than three decades of corporate collapse, continued criticism of accounting was the result of inaction by regulators in general and the accounting profession in particular. Complaints regarding the unserviceability of accounting and published financial data continue to pervade commercial discourse, notwithstanding changes from accounting self-regulation in the 1950s to the present regime of mixed government and professional intervention. Over the years a miscellany of Accounting Standards has been issued and legislatively endorsed. Diversity in the outcomes of accounting for similar commercial events remains, misleading data prevail – creative accounting reigns supreme. Our *leitmotif* is that corporate consumers, i.e. the users of corporate accounts, have not been served well. That observation remains apt as another round of turbulent economic activities has resulted in many, often *unexpected*, corporate collapses. Again market confidence is shaken as the trust in the reported information – the glue of the capitalist system – is proved to be unreliable.

Standardisation of the inputs to the accounting process has been based on an incorrect premise that controlling the input necessarily enhances the quality of the output. Uniformity of process has been substituted for the serviceability of output. Unless there is a shift from the present thinking and the practice it nurtures, the current criticisms of the products of accounting and auditing filling the financial press are destined to continue. The increased litigation in the 1990s is bound to be repeated during the next round in the cycle of economic boom and subsequent corporate failures.

Corporate collapses uniquely provide the raw material for a post-mortem of the *system* of accounting and auditing currently endorsed. Liquidators' accounts, and the official reports of Inspectors into failures, give an unusually candid insight into the administration of companies and provide a contrast between the financial truth of their positions at various times during their lives and what they reported them to be. While perhaps not the primary cause

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of corporate collapse and financial shenanigans, accounting has systematically failed to inform its consumers adequately, and in a timely fashion, of the drift of the financial affairs of businesses towards impending failure, leading to involuntary wealth redistributions along the way and, in some cases, exacerbating the extent of the financial losses.

The new millennium has revealed that the buck-passing feature of the accountancy profession's response to company failures is a repeated theme. Nine major Australian corporate collapses from the 1960s, '70s and '80s were examined in detail in the first edition, while others were referred to briefly. These were purposely selected for the specific instances they illustrate, the universality of the organisational and accounting practices they entailed, and the defects in the financial data that resulted. They flesh out the role played by accounting in the financing, investing and other managerial moves prior to a corporate collapse. This revised edition provides additional Australian case analyses – one in depth – HIH, and other case vignettes – Patrick/MUA, Ansett, One.Tel, and Enron in the US. Some of the 1960s case analyses have been truncated. Accounting is shown to have been a willing traveller, revealing in many instances surprisingly very little along the corporate path to failure. Many of the companies examined collapsed unexpectedly, just after reporting healthy audited profit figures. Ineffective regulatory action also is shown to have played a role.

While not highlighted in the collapses covered here, we do not wish to downplay the possibility of managers' intent to deceive, using, amongst other things in the 1980s, new financial instruments, such as derivatives, and put and call options, sometimes off-balance sheet, as evident in the special purpose vehicles used at Enron.

Chapter 2 precedes those analyses by inquiring into the notion and significance of *creative accounting*. This contrasts with what we have coined *feral accounting*, the use of a specific accounting practice with the intention to mislead. But the effects of creative accounting are equally insidious. While there is equivocation within accounting and regulatory circles regarding the precise meaning of creative accounting, there are sound reasons why it has arisen repeatedly as a matter of importance in corporate post-mortems.

The utterances of the accountancy profession over the last 40-odd years in response to complaint and criticism of the product of conventional accounting are an old refrain. Arguably, the profession has remained reactive in responding to the need to have accounting produce financial data serviceable for assessing the wealth and progress of corporations. Professional attention has been directed to important, but mainly peripheral, issues. Overall, the generic defects that have beset conventional accounting practice for decades have survived virtually intact into the new millennium. Particular practices have been

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outlawed, but the generic organisational and accounting defects to which they contributed remain. Official standards-setting bodies have been established and modified over time. They continue to receive increased resourcing. Due process for forging Accounting Standards has been devised and revised, but the quality of the end products has not improved. Events at HIH, Enron and other recent collapses confirm that it has deteriorated. A miscellany of often inconsistent processing and valuation rules continues to form the basis of the compulsory conventional accounting procedures and policies. Diversity in accounting practice persists. The practices it endorses imply that the profession has retained its long-stated position that the balance sheet (or, in today's idiom, statement of financial position) is not a statement of net worth and that all that is required is that the public be educated as to the limitation of accounts. When there is an inquiry invariably the public is fed the notion that the financial data are misleading and creative, by virtue of practitioners deviating from, or deliberately misinterpreting, the prescribed Accounting Standards. Those analyses have lacked the Jesuitical verve so necessary to get to the truth. The reality from our perspective is that compliance with Accounting Standards is as likely a major cause of accounting creativity. The equivocal data underpinning the dispute in the HIH Royal Commission regarding assessments of HIH's solvency, and the use by Enron of special purpose off-balance sheet entities to quarantine group liabilities are apt new millennial examples. Unquestionably, there remains chaos in the counting-house.

A siege mentality has prevailed when analysing various accounting anomalies, including those associated with corporate failures. Repeatedly, blame has been sheeted home in the financial press and the professional literature to the nebulous 'bad management', inadequate compliance with Accounting Standards and ineffective regulatory monitoring of that compliance, contiguous with criticisms of declining business ethics and even poor accounting education. Everything, it would seem, has been at fault, except the patchwork bases of accounting and its unserviceable products. Chapters 16, 17, 18 and 19 examine those matters in some detail. Buck-passing is endemic to an immature profession – the current system of accounting deserves to be put on trial; hence our sub-title, *Accounting, regulatory and ethical failure*.

Anecdote supports the view that a virulent form of social injustice has emerged within the commercial and business community by virtue of the compulsory production of financial data unfit for the purposes for which they are commonly used. Radical restructuring of conventional accounting practice is needed, a matter pursued in Chapters 17, 18 and 19.

Effective reconstruction of accounting is impossible without reform of the legal and social structure in which it operates. Some of the current legal

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structures demonstrably need to be abandoned. Others need remodelling if they are to fulfil their traditional objectives. In this context Chapters 16 and 17 contest the role of, and the continued need for, subsidiaries and labyrinthine corporate group structures. Some of the pervading practices of accounting require a closer look by a more critical eye than the regulators appear to have given them. Regulators continue to examine and monitor accounting practices but fail to consider proposals outside of the conventional. In Chapter 19 it is demonstrated that some approved practices are without commercial foundation, others are without a coherent structure and many have neither foundation nor structure, in the social setting of property rights and a financial system in which money, prices, price levels, price structures and markets have a dominant place.

This case for reform emphasises various aspects of corporate failure, especially the commingling of accounting, financing and investing in the managerial process. In that process the market worth of physical assets is an essential element in assessing a firm's solvency, its capacity to borrow, whether to liquidate specific assets and redirect resources and otherwise adapt to changing circumstances, as well as to any calculation of its wealth and financial progress. The HIH Royal Commission is examining the issue of solvency in respect of HIH and related companies as part of its brief. Neither internal nor external *informed* financial decisions can be taken without that information mix. This commingling provides the context for analysing the role of accounting. The reform proposal proceeds with the firm conviction that the public at large are consumers of financial information regarding the companies they deal with, are employed by, invest in, and otherwise are related to in the wider economy. That information product is currently of poor quality. A leading standards setting authority, Sir Bryan Carsberg, and eminent practitioners and regulators like former Chief Accountant of the SEC Walter Schuetze rate the current quality of reported financial information lower now than it was decades ago.

What follows may cause offence to those who hold dear the conventional practices and conventions of accounting. There are mental blinkers or a shutter on an open debate when it comes to being critical of accounting practice *from within*. Over the years, leading accounting authorities Leonard Spacek, Ray Chambers, Robert Sterling and Abe Briloff, *inter alios*, have been witness to that. Questioning the *status quo* is often denigrated, false motives often attributed, the character of those who question often impugned. Yet, the reality is that practitioners, the professional accountancy bodies, and the legislative and quasi-legislative agencies regulating corporate activity have not scored too highly in developing and monitoring a system that meets consumers' needs. Accountants *per se* are not under attack here. It is our profession too and we

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are less than happy with the way it is regressing. Accountants have to practise with a system that places them at great risk – damned by the consumers of accounting in many cases if they comply with approved Standards and damned by their governing bodies in all cases if they don't. Mostly, none of that is their fault – it is the *system* we put on trial here.

It is reasonable for the wider community to wonder why this situation has arisen. Why, given accountants' specialised knowledge of their craft – its *differentia specifica*, an inside view of the difficulties they face and the litigation danger they confront – practitioners have not forced corrective action before now.

Likely as not, many believe the current Standards-setting exercise is corrective action. Our thesis is that the proliferation of official Standards and their mandatory compliance has not addressed the problem. Perhaps accountants have not mastered the intricacies of their own inventions – the accounting artifacts. Perhaps they are too close to the action, not sufficiently detached or independently placed, to see it for what it is – warts and all. Oscar Wilde captured that quirk of human behaviour in his *An Ideal Husband* – perhaps they have had all the experience but not had the privilege of 'making' the 'observations'.

Our hope is that the observations that follow will jolt accountants and company regulators into long overdue action.

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Finally, we publicly acknowledge our gratitude to Angelika and Nicole Dean, and to Jeanette Clarke, for their continued encouragement and forbearance over the many years it took to bring our examination of corporate collapse and accounting to this point, and to the accounting iconoclast Ray Chambers, without whose mentorship and inspiration (even in death) it would never have commenced nor have continued into a second edition. It is with much sadness that we note that Ray Chambers died in September 1999 after suffering a fall. Through this revised edition his ideas remain, in his words, 'an irritant to the accounting profession to ensure that it continues to seek ways of continually improving its practices' and concomitantly to improve the products on which users of accounting information so desperately rely. Only then will the market system be able to restore the public trust that has been so shaken over the years by events like those at, say, HIH and Enron.

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