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FIRMS AS ADAPTIVE ORGANIZATIONS:
THE CASE OF AUSTRALIAN TRADING BANKS.

by Julie Tabart-Gay
Bachelor of Business (Accounting)

This thesis is submitted in partial fulfilment of the requirements for the degree of Master of Commerce
School of Accounting and Finance
Faculty of Management
Deakin University
December, 1993.
I hereby certify that the thesis entitled **FIRMS AS ADAPTIVE ORGANIZATIONS: THE CASE OF AUSTRALIAN TRADING BANKS**

and submitted for the degree of **Master of Commerce**

is the result of my own research, except where otherwise acknowledged, and that this thesis (or any part of the same) has not been submitted for a higher degree to any other university or institution.

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Date ....1.3.1993............
The conventional accounting notion of 'going concern' — that a firm will continue its business operations in the same manner indefinitely — has underpinned accounting practice for over one hundred years. This idea has provided a rationale for spreading costs over accounting periods and for deferring costs as assets in balance sheets.

An alternative idea that is widely regarded as reliable in the literatures of economics and deliberate action is that firms continually adapt to changes in market and economic conditions. That is economic behaviour. The implications of that view of a firm for accounting have been systematically explored by Chambers (1966). While not examining those particular implications, many other accounting theorists have been critical of the conventional accounting idea of 'going concern' and of its impact on accounting practice.

The two notions of 'going concern' — as static or adaptive enterprises — are examined by referring to the business operations of the four major Australian trading banks over the period 1983—1991. Banks were selected because they are commonly thought to be particularly 'conservative' organizations. The period 1983—1991 was chosen because it covers the era of deregulation of the Australian financial system.

The evidence adduced by this study indicates that the Australian trading banks have continually adapted their organizational structures and business operations in the light of changes in technology, markets for financial services, government policies and domestic and global economic conditions. Illustrations of adaptive behaviour by banks are drawn from their normal operating procedures such as the provision of products and services, loan services, acquisitions, sale of property, non-core banking operations and international banking.

It is argued on analytical grounds that the cost basis of accounting does not yield financial statements that provide factual and up-to-date information about the financial capacity of firms to pay their debts and to continue trading generally; that is, to be going concerns. At any time, those financial capacities are determined by the amount of money commanded by a firm, including the money's worth of its assets, and by its level of debt. It is concluded on empirical grounds that the Australian trading banks, at least, are adaptive entities.
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CHAPTER ONE

THE PERIODICAL ACCOUNTING PROBLEM

Accounting is the process of recording a firm’s business transactions from one date to another, generally referred to as the accounting period. This requires accurate and dated memoranda entries to be kept in the firm’s journals and ledgers. At the end of the accounting period these entries form the basis for the adjusted account balances transferred to the firm’s financial statements. These dated financial statements are compiled to provide information about the firm’s financial position as at their date and trading performance for the specified period.

Conventional accounting practice is predicated upon the assumption that a firm will continue its business operations more or less in the same manner indefinitely. This results in conventionally prepared financial statements providing users with non-factual information about the financial capacity of a firm to continue to engage in trading activities. The idea that accounting provides financial information to assist users in decision-making has been repeated by authors over a number of decades. For example:

‘...a balance-sheet is...prepared for the purpose of showing to all concerned the financial condition of the business as a going concern.’

Sanders, Hatfield, & Moore (1938, p55)

‘Accounting...is characteristically a technical mode of interpreting financial data for the information of managers, owners, and other interested parties.’

Paton and Littleton (1940, p119)

‘...a principal function of accounting data is to serve as a fundamental tool in the evaluation of past decisions...’

Edwards and Bell (1961, pp3,4.)
Financial decisions are based on the accumulated knowledge of the decision-maker, existing economic circumstances and the quality (in terms of relevance and reliability) of the available financial information. Periodical accounting reports may contain details which in a general way provide information for use, but specifically do not provide periodically factual financial details. Put another way, conventional accounting practice produces dated financial statements about a firm that do not contain time and circumstance specific financial facts about the entity.

The identification and subsequent reporting of time specific transactions, such as the flow of goods into and out of the firm during a period and the remaining stock on hand is an example of a fundamental accounting problem. Of particular importance are the durable items held by the firm and the manner in which they are recorded at the end of the accounting period.

Two basic methods are:

1) direct observation of the market at the end of the accounting period, to acquire a factual dated monetary amount equivalent to the assets held by the firm at that time; or,

2) an indirect method of estimating a dated residual amount by cost and conjecture, a non-factual process.

During the twentieth century, the accounting profession has seemed satisfied to use methods which produce estimated monetary amounts as acceptable equivalents for the assets of a firm at a certain date. The acceptance of cost valuations adjusted from time to
time to suit different contingencies, such as depreciation schedules, or satisfying directors' or expert revaluation of fixed assets, has become a significant part of financial statement preparation. Alternatively, establishing a market for a current monetary equivalent for an item has resulted in the notion of its liquidation value, so estimated dollar amounts have become dominant in the compilation of a firm's financial statements of periodic financial position.

That conventional accounting assumes a firm to be a 'going concern' has been previously mentioned in this chapter and the meaning of the term 'going concern' may seem self evident. What is not self evident is that there is any connection between estimated dated residual amounts in a firm's financial statements, and management's business performance in a changing environment. That is, whether the statements in fact provide information about the financial consequences of management's trading decisions during the period. The conventional 'going concern' notion implies that a firm is both a static organization and one with a continuous life.

1.1 Aim of this Study.

The aim of this study is to examine the legitimacy of the conventional accounting notion of 'going concern' by reference to the business operations of the major Australian trading banks during the period 1983–1991.

This industry has been chosen because it is often viewed as conservative and might be reckoned upon to provide a reasonable indication of the style of business operations that existed in the economic environment of the eighties. The period 1983–1991 was selected to determine the reaction of the banks to deregulation of the Australian financial industry, and to assess whether the banks continued operating in the same manner or responded to
economic changes as they occurred. Wells (1976, p479) stated '...Gynther's view of firms is of ongoing nonadaptive organizations while Chambers sees organizations as being fluid and constantly adapting to environmental changes.' Evidence exists and will be discussed in chapter four, to support the idea that economic environments change and firms meet new challenges as they arise.

1.2 Elaboration.
Adaptive or economic behaviour reflects the business operations of trading entities within a market as they interact with the demands and opportunities of that market. 'The expectation of an indefinite life does not entail that every operation selected to carry out its functions shall be carried on indefinitely.' Chambers (1966, p203) Management makes business decisions to achieve continuity of operations, financial gain, and organizational growth in line with technological change, competition, and consumer demands. Economic behaviour is deliberate action by decision makers to implement choices that they see to be beneficial to the firm at that time and in the future. 'Changes in financial position are continual; changes in the state of satisfaction are continual; adaptation or its pursuit is a continual process, or, more strictly, a continuous cycle of processes.' Chambers (1966, p124)

Accounting authors have criticized conventional accounting methods for producing financial statements that do not contain up-to-date financial information about a firm, for example:

Paton (1922, p425) asserted that financial statements '...should consistently reflect true pictures of current business conditions...';

'Beyond doubt the accountants would like to mean by "financial position" a position declared by direct positive measures of funds...'; Canning (1929, p191)
'...ordinary accounting procedure is not suitable for indicating whether an enterprise has approached nearer the usual goal of economic activity, viz., increase in the general purchasing power of the owners' investment in the enterprise;

Sweeney (1936, p24)

'...Accountants (have a) duty to record present values under conditions as they are...' MacNeal (1939, p145)

'To exclude from accounts the private opinions and judgements of those who prepare them, entails that the specifications of accounts require that their components shall have empirical referents in markets as at the dates nominated in them...Unless accounts are specified to have this character, they may not be properly described as being "objective", "credible" or "independently testable".'

Wolnizer (1987, pp158,159)

The conventional idea that a firm is a 'going concern' unless evidence exists to the contrary also assumes the firm has the financial capacity to keep on trading. 'The going concern concept may be a valid description of the accounting entity, if it is justified by evidence in the particular case but not if it is offered as an untested general assumption.' Fremgen (1968, p650) A case can be made that financial statements are of increased benefit to decision makers when they contain evidence of a firm's solvency.

Conventional financial statements do not provide evidence of a firm's financial capacity to trade, they detail the results of various calculations that have become accepted as accounting practice. There is no determined effort to provide current financial information to assist users in their financial choices. Usefulness in decision making, however, is often held to be the guiding rationale for financial statement preparation. 'The only convenient representation of a firm as a whole which is relevant to the purely financial interest of an investor is its set of financial statements.' Chambers (1966, p277)
Financial information may assist management in making policy decisions on investments, inventory levels, production quotas and staff levels for a business. Effective management performance may be the outcome of deliberate action on choices made from accurate, timely financial information provided by the accountants within the entity. Results from management decisions, will, other things being equal, only be as good as the quality of the financial information that formed the basis of those decisions.

Whether up-to-date and factual financial information or calculated residual (non-factual) amounts provide users of financial statements with relevant and reliable financial details to help them in their decision-making is a question to be determined. ‘In general, financial position is a position with respect to asset valuation and constitution rather than with respect to capital value of the enterprise.’ Canning (1929, p191) Periodic changes in assets listed on the balance sheet indicate the changing structure of the entity and management strategies for the firm’s future survival and growth, in response to changing economic conditions.

The output from industry has been linked to market demands for decades, and business entities have reacted to the economic realities of supply and demand by changing business operations in response to current economic environmental conditions. ‘...the industrial establishment of the country is becoming more closely geared to consumption requirements.’ Canning (1929, p325) Conventional accounting practice, however, remains fixed in its focus on a business firm as a static entity. Now, the point for consideration is the relevance of this idea in a dynamic environment.

1.3 Structure of this Study.

This thesis consists of five chapters including this introduction.
Chapter 2 provides an overview of the accounting literature on the 'going concern' notion and explains the conventional idea.

Chapter 3 examines the notion of economic behaviour and how this relates to a firm operating in the market place. By referring to the literature of economics and deliberate action, it is shown that an alternative view of a firm — as an adaptive entity — is widely held in fields other than accounting.

Chapter 4 provides examples of business operations of the four major Australian banks during the period 1983–1991 that illustrate the volatility of the finance industry during that time and the responsive manner in which the banks have conducted their affairs.

Drawing on the information provided in their annual reports, it is shown that, since deregulation, Australian banks have adapted to changed industry and economic conditions by sale of fixed assets; expansion; acquisitions; pursuit of new objectives; and diversification within the normal course of business operations.

Chapter 5 concludes that the Australian trading banks have conducted their businesses in a manner consistent with the notion of firms as adaptive enterprises.
CHAPTER TWO

CONVENTIONAL GOING CONCERN NOTION.

‘One of the factors generally considered to be
essential to the health and survival of an entity
is the need to meet commitments as they fall due.’

Newman (1988, p29)

Underpinning conventional accounting practice is the idea that a firm will continue in
essentially the same line of trade indefinitely. This notion known as the ‘going concern’
convention, is the rationale for spreading costs over multiple accounting periods and for
representing assets periodically by unamortized costs. The products of such cost
allocations do not relate to the real world; they are not indicative of a firm’s solvency, debt
paying ability, or general purchasing power and it is these real world states which
determine whether a firm has the financial capacity to continue trading.

This chapter examines the conventional ‘going concern’ notion as it has been expressed in
the literature over the past 100 years.

2.1 The Conventional Accounting Idea of a ‘Going Concern’.
The conventional accounting idea of a firm as a ‘going concern’, the assumption that the
business will continue operating in the same manner indefinitely, has not been clearly
developed in either accounting literature or professional pronouncements, although much has been written on the subject this century.

There is no agreement on what constitutes a 'going concern' value. Dicksee (1892) referred to realizable value as relevant to the 'going concern'. This method acknowledges that during an accounting period (one balance sheet date 19X1 to the next 19X2) realizable prices of assets in the market will change, but there is no adjustment made for the change in the purchasing power of money that occurs over time mainly due to inflation.

Gilman (1939), Paton and Littleton (1940), and May (1948) considered historical cost to be applicable to the 'going concern'. Cost represents an outflow of cash for a firm at purchase date, the transaction recorded in the firm's books is a memorandum entry of the event. The information soon becomes historical with recorded amounts relevant only to the transaction date due to the changing value of money. Date specific costs (that relate to different periods) cannot be sensibly added together for the significance of the monetary unit changes over time. The historical cost basis for reporting financial position of a firm does not generally adjust originally recorded money amounts for any time difference. However, if costs are adjusted each period to reflect a current cost as at balance sheet date the amounts are representative of an outflow of cash for the firm, which does not represent the money amount available to the firm to continue transacting business. In order to continue business operations beyond a current accounting period a firm's financial capacity to meet its debt obligations when due and participate in market transactions needs to be determined.

Carson (1949), Edwards and Bell (1961), Ladd (1963) and Sprouse (1966) argued for replacement cost. This method of valuing assets is concerned with maintaining the 'operating capacity' of a firm but does not ensure the availability of money to replace any
particular asset. Conjectures are made about the useful life of assets and depreciation amounts are derived from a calculation based on an average of the asset's replacement cost in a current year. The replacement cost of an asset is synonymous with a potential outflow of cash from a firm and this information does not give interested parties financial details of the entity's capacity to continue operations. It provides financial amounts that represent the cost of replacing the item at that date but plant and equipment are rarely replaced in the same type due to expansion, technological advances, or a change in products manufactured.

Chambers (1966) advocated current cash equivalents as the relevant asset value for a 'going concern'. The value attributed to the individual asset is decided by the market and represents its current selling price. That is, monetary amounts the entity may choose to realize instead of retaining the asset and so can depend upon to cover debts and provide for continuing business operations at that date.

Although agreement on a 'going concern' asset valuation has not been reached, convention has dictated the use of historical cost. Authors such as Storey (1959), Fremgen (1968), Sterling (1968), Yu (1971) have questioned conventional wisdom in accepting the idea of a 'going concern' as an untested assumption underlying practice.

Storey (1959) was concerned with the problem of asset valuation for a 'going concern' and implications resulting from what he perceived to be an incomplete theory. "The...going concern assumption...left a gap in accounting theory which was filled by the realization convention...[with differences] in the area of fixed assets...the area of basic conflict lies in the...current assets...[where] only cash and receivables are valued the same under the two conventions..." Storey (1959, pp237, 238).
Fremgen (1968, p650) stated '...continuity should be a judgement based on evidence in the case. Thus, if relevant at all, continuity would be a conclusion, not an assumption.' He emphasized that different opinions existed about the matter of asset valuation for a 'going concern'. The fact that different ideas have persisted over time on the valuation of assets, and on what constitutes a 'going concern', illustrates the dilemma that exists within accounting directly related to a fundamental criterion used in compiling periodic financial information on a firm. 'Continuity is a tenuous assumption at best.' Fremgen (1968, p656)

The purpose of Sterling's paper was '...to make some exploratory probes into the going concern concept.' He sought the precise meaning of the concept and questioned the validity of using historical cost valuations. 'We cling to historical cost because the purchase price is a past fact and therefore "objective and verifiable". Yet we allocate that purchase price on the basis of what the future holds...It is difficult to justify the assumption of a going concern because of uncertainty about what the future holds...'
Sterling (1968, pp 497,501)


Yu concentrated on the importance of the complete operating cycle of a business. He stated (1971, p45) '...the going concern concept is a total concept, meaning that conceptually it is applicable only to a firm as a whole...The cycle of operations embraces all phases of the economic activity of a business enterprise..."orderly liquidation" of individual assets does not interrupt the revolving nature of the cycle; rather, it generates power to the
movement of the cycle.’ (1971, p51)

Although these studies have been published over two decades, the ideas and challenges of the authors have been effectively ignored. No change to the general acceptance and habitual use of the conventional going concern assumption has been proposed by the profession or advanced by textbook writers. Financial statements continue to be published at a particular date without evidence of a firm’s financial ability to trade and pay its debts as at their date. The assumption that a firm is a ‘going concern’ in the conventional sense remains firmly established as a fundamental base for financial statement preparation.

The concept of a business firm continuing operations into the future is not of concern. The concern is with the financial capacity of the business to continue trading, and that the firm will continue doing business in the same style for an indefinite period. ‘...bookkeeping for a completed venture was entirely historical, for a going concern it became a problem of viewing segments in a stream of continuous activity.’ Chatfield (1977, p82)

2.1.1 Origin of the Conventional ‘Going Concern’.

The conventional ‘going concern’ idea can be traced in the accounting literature at least back to Dicksee (1892). Eddie (1983, p6) has suggested that the idea was entrenched in accounting before Dicksee’s writings. During the 1800’s marked environmental changes occurred within many economic communities that affected the way merchants recorded daily business transactions. There was a move away from sole proprietorships, to partnerships, then chartered and incorporated companies, and finally limited liability companies. This was in part due to the industrial revolution which brought sweeping changes to the way in which business was conducted and resulted in the birth of a variety of complex manufacturing entities. These firms began to produce large quantities of
merchandise and production on this scale required new and more complex machinery.

The production process became a continuous cycle of operations that progressed from day to day and into the future. Concern then arose as to the recording of a firm's business transactions in the changed economic circumstances and how to account for the firm's continuing production activities. Accounting practitioners began to implement procedures like allocating expenses, deferring charges, depreciating equipment, classifying expenditures as assets or expenses, because the firm was viewed as having an indefinite life carrying out the same style of business operations.

In time firms that were considered financially sound collapsed, sometimes shortly after the publication of financial statements that contained no indication of impending financial difficulties. Periodic financial statements were introduced to provide investors and other interested parties with information that would otherwise only be available to selected officers of the firm, and to offer a degree of protection for investors by providing financial details that would assist them in their decision making. Statutory requirements for the preparation and publication of these financial indicators of a firm's trading ability had been introduced by the mid nineteenth century.

2.1.2 The 'Going Concern' Convention.

Throughout this century the 'going concern' idea has continued to prevail to the present time, with the consequence that conventional accounting practice has become firmly attached to the notion. Dicksee (1892) thought that firms were mainly concerned with continuing business operations from one period to the next and into the future, and this idea directed his interest to the valuation of assets.
‘...the statutory requirement that all capital raised should be used for the carrying out of works for the execution of which the company was created; and, so long as the works were maintained in a state of efficiency their actual value need not be periodically reconsidered, arose from the circumstance that it was contemplated that the work authorised would be permanently carried on.’ Dicksee (1892, p119)

The conventional ‘going concern’ concept has become well established over the years since 1892. The following quotes illustrate the continual reference throughout accounting literature to the ‘going concern’ idea during that time, and the rationale for justifying cost allocations, cost deferrals, estimates, and speculative monetary amounts in financial statements. Dicksee (1892, p282) suggested that ‘...because the undertaking is a going concern...it must necessarily follow that in the vast majority of cases absolute accuracy is hardly to be looked for...’

Accounting for the assets and liabilities of a firm from one period to the next by inference demands accurate reporting of the entity’s financial position. A business can only continue to operate in the market if it can pay its debts and produce products or services that satisfy current consumer demands. ‘The concept of continuity is...important in that it complements and strengthens the concept of earning power.’ Paton and Littleton (1940, p10) Firms are interested in generating income and the potential to increase earnings and profits as time passes, but a business that has the potential to continue operating and earning money must be a solvent enterprise and that state needs to be established rather than assumed.

‘The going—concern concept is an assumption that every accounting entity, in the absence of specific information to the contrary, will continue indefinitely and that the business will outlive its most durable asset.’ Holmes (1969, p690) If it is an objective of accounting to
provide useful, reliable, relevant information for decision makers then evidence of a firm's financial capacity to continue in business and its intentions, if any, to liquidate durables during its operating cycle is essential. Manufacturing organizations throughout the world alter operating procedures from time to time in an effort to cut fixed and variable costs, to accommodate the mechanics of newly installed equipment. If a machine has been upgraded or replaced by completely different equipment due to product changes or enhancements, assets the firm may have classified as fixed assets have probably been sold into the market or liquidated in some other manner.

'The traditional version of the going concern...is a static one...' Yu (1971, p38) A custom that has been handed from one generation of accounting professionals to the next is not necessarily without fault. It becomes a responsibility for those of succeeding periods to question procedures and methods previously taught and practised to maintain a continuing process of self-correction that will ensure the highest quality output. Assumptions made by accounting professionals have endured for decades and affected many aspects of accounting practice. Some practitioners view a firm as a static entity others consider it a dynamic enterprise. This basic difference of opinion leads to disagreements over asset valuation, justification of continuing activity, and what determines the life of the business.

The static view leads to the assumption that a firm continues its activities into the future in the same manner and has the financial capacity to sustain operations. 'Closely related to the concepts of continuing activity and the accounting period is that of the going concern. In addition to the firm maintaining its activities on a continuing basis from the end of one period into the next, the assumption is normally made that the firm can justify its continuing operations into the indefinite future.' Barton (1982, p42). 'The (going concern) postulate assumes either that the entity is not expected to be liquidated in the foreseeable future or that the entity will continue for an indefinite period of time...'
Belkaoui (1985, p221)

Endorsement of the conventional 'going concern' idea within accounting literature has occurred over many decades, regardless of the questions raised by authors as to its efficacy.

2.1.3 Authority Adds a Cloak of Respectability.
Support and authority for acceptance of the 'going concern' idea has been established by the professional accounting bodies and standard setting boards throughout the English speaking world. Such organizations have defended the use of this assumption in accounting practice by accepting it as a fundamental requirement for financial statement preparation.

Conventional financial statements are prepared in accordance with Australian Accounting Standards (AAS), which are guidelines used by the profession to encourage uniformity of accounting practice. Compliance with the standards is a requirement of the accounting professional body and when passed by the Australian Accounting Standards Board (AASB) is a legal requirement of publicly listed companies. AAS6 (p1051) states that '...in the absence of evidence to the contrary, the entity is expected to continue in operation without any intention or necessity to liquidate or to curtail significantly the scale of its operations.'

However, accounting procedures that ultimately report on a firm's financial details require a demonstrable truth as the base. If the basis upon which financial statements are compiled is incorrect, then the statements in their entirety are wrong. 'The going concern basis is so generally adopted in the preparation of financial statements that its use can be assumed in the absence of any statement to the contrary.' (AAS6, para 7) An idea that has been generally adopted as acceptable accounting practice does not necessarily mean that the resulting procedures are correct or produce the desired outcome. A concept that
has been used for an extended period may be rationalized but not justified if the concept is an untested assumption.

There has been no attempt to explain in detail what is meant by the word "going" in 'going concern'. The Oxford English Dictionary gives several meanings, for instance, '...to proceed; depart; move...be functioning...be sold...'. In conjunction with a business these words imply some kind of change like acquiring new premises, disposing of old machines for newly developed high-tech equipment, manufacturing an improved product, increasing employee numbers, entering a new industry. To continue operating a firm must have sufficient funds to pay for labour, materials, maintenance and repairs, rent, electricity, and any other fixed or variable expenses incurred. A manufacturing organization needs to compete effectively to ensure continuity of business operations but not necessarily the same operations.

To illustrate this idea, consider some of the daily operations that occur within a factory environment such as a clothing manufacturer. A quantity of raw material (wool, cotton, polyester) sent to the cutting-room to be cut into various pieces that will eventually be sewn into a particular garment (jacket, skirt, dress, blouse). The pieces labelled (left-front, right-front, back, left-sleeve, right sleeve, collar) are taken to the machine-room where a number of machinists sew certain pieces together. This piecework enables machinists to quickly sew particular parts of a garment and pass the partly completed product on to the next section. The aim is for the production process to be effectively completed in the shortest possible time. Technological advances over a period of time means that industrial sewing machines, fabric cutting equipment, trolleys to transport cloth from one production area to another, mechanisms to move pieces of fabric and partly completed garments between machinists are improved and factories continually update their equipment to ensure efficient and effective production processes. A firm may
continue to manufacture the same type of garment over a number of years but the likelihood of the production process remaining the same is negligible.

2.2 Consequences of Adoption of the Conventional ‘Going Concern’ Idea for Financial Statement Preparation.

Financial statements serve to inform interested parties about the financial position and performance of a firm as at a certain date. The details presented are required by the profession and statutory authorities to present a ‘true and fair’ view of a firm’s financial position as at a date and of financial results for a particular accounting period. Due to the use of conventional accounting procedures financial statements made about the capacity of a firm to continue trading, have developed into statements that reveal the operating results of a firm as the product of a calculation, instead of an observable truth.

Accounting procedures, like depreciation charges and the matching of deferred expenses with future and unknown revenues, subsequently arose from adoption of the conventional idea by accounting practitioners. As firms increasingly invested in durables with an unknown useful life, the notion of calculating depreciation instead of looking to the market to ascertain if the item had in fact depreciated, or appreciated in monetary terms during the period became general practice.

2.2.1 Technical Flaws of Conventional Accounting Methods.

Authors have questioned the use of conventional accounting methods. For example, ‘The going concern concept in accounting provides a point of view to facilitate and implement assembling, communicating, and interpreting enterprise financial information. However, there is not complete unanimity of opinion as to the
application of the going concern to the financial data of the firm.'
Wiseman (1959, p633)

'A strong case can be made that the accounting reports ought to show something
about the likelihood of the firm continuing instead of the reports being
prepared under the assumption that it will continue.' Sterling (1968, p494)

'...some practitioners are beginning to complain of the unrealistic nature of the
going concern assumption underlying financial statements.' Yu (1971, pp37,38)

The conventional balance sheet may list assets at historic cost, replacement cost, director's
or expert revaluations or a combination of these or other valuations. Depreciation of some
assets is required by the accounting standards, which reduces recorded cost and the stated
value of the asset in the balance sheet. If the depreciated item is actually appreciating in
current monetary terms within the market, this change is not recognized unless a
revaluation of a class of assets is considered by the officers of the firm, and then the
revaluation may or may not relate to current market values.

Depreciating the cost of a capital item by formula provides a method for spreading costs
over a number of accounting periods, to reduce the impact of expenditure on the current
income statement. It also reduces the likelihood of a firm reporting widely fluctuating
operating results, and suggests a more even dispersion of expenditure than has actually
occurred. Depreciation by formula however, fails to account for the possible appreciation
of the item during the period.

Deferral of an expense to a future accounting period reduces the effect of the expense on
reported periodic profit. This may be an advantage to the firm, but is misleading for the
users of financial statements. An expense incurred by an entity at a certain date effectively reduces the amount of available funds the firm may use for trading purposes at that time. If expenses incurred during a particular period are reported over two or more periods the recorded accounting information will not accurately report the financial consequences of the firm’s periodic business transactions.

Recording an entity’s business transactions during an accounting period requires knowledge of those transactions and appropriate bookkeeping skills to document them, but such knowledge does not presuppose the ability to guess at a firm’s future business. Accounting is not fortune telling, and so the financial statements of a firm are unreliable, except by chance, when the accounting data upon which they are based comprise arbitrary allocations, deferrals of revenue and expenses, or depreciated costs, because these factors require conjecture. ‘Allocation is the process of assigning or distributing an amount according to a formula (e.g. allocating overhead costs to departments and products)....’ Barton (1982, p43)

2.2.2 Concept of Matching Current Expenses with Future Revenues.
The matching concept means that part of current expenditures are deferred in an attempt to match current costs against future and unearned revenues. Australian accounting standard AAS9 – ‘Expenditure Carried Forward to Subsequent Accounting Periods’, provides practitioners with guidelines for apportioning a firm’s current expense over future periods related to the expectation of revenue yet to be earned. The issue is not the calculation of revenues per se, but the assumption that there will be revenues against which to match the deferred costs.

An expense allocated across a number of future periods and matched against unearned and
unknown revenue amounts causes a firm's financial results of current business transactions to be devoid of commercial reality. Allocations of this nature are derived from mere opinion. The factual results of a firm's financial circumstances from a particular period are lost because the financial effect of some periodic transactions are deferred into the future, or an incurred expense of the current period is only partially reported.

Paton and Littleton (1940, p15) stated 'Not all costs attach in a discernible manner...' It is debatable, however, whether costs attach to certain single items at all or to specific components of a saleable item. An accurate matching of future revenue in proportion to the cost of producing each stage of a product may not be possible. In relation to items being time specific Harrison, Horrocks and Newman (1970, p48) remarked 'Some revenue and expense items are easily identifiable with a particular accounting period but for others the identification is far more difficult.' The fact remains that the process of matching a current cost with expected revenues is an arbitrary allocation of estimated monetary amounts across a number of future accounting periods.

Future revenues cannot now be known. Any calculation of them is, therefore, speculative and thus should not be counted as earnings. Changing circumstances within the economic environment may cause a change in consumer demands which may result in currently marketable products becoming unsaleable. If products have no market they cannot contribute toward a firm's future revenues; they cannot generate income.

A firm's financial state will be affected if only the cost of producing or purchasing products for sale is considered, without discovering whether the products are marketable and how much money consumers are willing to pay to purchase them. Survival of a business depends on financial capacity to continue trading and its ability to respond in a timely manner to consumer demands, industry competition, technological improvements, and
other environmental changes. 'Expectations as to the life of a firm as well as expectations as to the holding of its durable assets are constantly being revised.' Chambers (1966, p203)

2.3 Solvency and the Firm.

'The going concern assumption is not without defects. Statistics on the length of life of business undertakings do not support it. Mr May remarked that it does not represent "...a scientific truth or a completely rational assumption."'

Carson (1949, p35)

Evidence (rather than assumptions) of a firm's financial capacity to meet its debt obligations in a timely manner provides some assurance of solvency and the ability to survive within the market and continue trading. Any business prevented from operating due to a lack of required funds cannot be a 'going concern'. Moonitz and Jordan (1963, p123) did not agree. They stated that an '...uninterrupted continuity of operations is essential; and this going-concern concept involves more than maintaining a capacity to pay debts as they mature; it concerns the maintenance of an adequate supply of all services [assets] necessary for operations to continue into the future without interruption.'

 Provision and maintenance of services and financial benefits cannot be achieved without sufficient money to maintain business operations and provide marketable goods or services.

To ascertain the financial status of a firm management needs up-to-date, factual, relevant and reliable financial information about the entity, which will provide current financial indicators of the firm's ability to pay its debts when and as they fall due, the extent to which the firm is geared, and the firm's profitability. The variety of choices within accounting standards provide managers with means to make misleading statements about a
firm's financial position at any time. Contradictory or confusing elements of accounting standards do not provide effective guidelines for accounting practitioners.

'...the accounting profession ... must prepare financial statements which are in fact what they purport to be, or it must eventually tell the public what financial statements really are, namely: a conglomeration of historical data, accounting conventions, and present facts, wherein no one can discern truth from fiction, and which are fully as likely to deceive the enlightened as the ignorant, to the advantage of individuals who have inside knowledge of the facts misleadingly exhibited.'

MacNeal (1939, p186)

Accounting convention requires that liquidation of a firm be considered when there is evidence of insolvency. During the normal course of business operations firms continually liquidate and replace assets but this fact is ignored by accounting convention. Assets are classified into current or fixed categories to define the likelihood of their liquidation in the short or long term. These classifications and the monetary amounts used to represent asset items in financial statements are the basis for financial ratio calculations. The calculated results from financial ratio analysis can only be valid when the monetary amounts used in calculations relate to the same time period, or as at a certain date. Issues such as dated solvency, dated debt to equity relations, dated rates of return, are disregarded by conventional practice.

Company accounts must include a directors' statement and that statement incorporates a reference to the solvency of the firm. 'The statement shall state whether or not, in the directors' opinion, there are, when the statement is made, reasonable grounds to believe that the company will be able to pay its debts as and when they fall due.' Corporations Legislation 1992, s301(5). This means that, to abide by the law, directors must gather
evidence that indicates the liquidity and solvency of the firm. But conventionally prepared financial statements do not provide this information because they are based on an assumption that the firm is a 'going concern'; not evidence that the firm is solvent and has the financial capacity to be a 'going concern'.

2.3.1 Financial Measurement: Confusion and Distortion.

All periodical changes in monetary equivalents of assets held are relevant to the availability of cash and cash equivalents which determine the level of a firm's financial capacity to pay its debts, trade in goods and services, and continue business operations generally. 'Continuity entails success and it is an error to assume success when that is what was set out to be measured.' Sterling (1968, p484)

The sum of the monetary equivalents of a firm's marketable assets which reflect a possible inflow of cash to the firm establishes its financial capacity to continue trading. Unsaleable items have no market and no potential for cash conversion. These items are no use in determining a firm's financial capacity to cover debt obligations as at the date of the statement. Such items may contribute to the future earning potential of an organization. For example, the manufacturing process of a firm may be improved and productivity increased, and a reduction in overall manufacturing costs achieved by the firm's acquiring and using a specifically designed machine that is of no use to another business. Increased earnings would be reflected in future income statements. The asset would have an intrinsic value for the firm but be an expense within the accounting period in which it was purchased.

Conventionally prepared financial data may be accurately compiled as per the guidelines set by the accounting profession and the law, in the form of accounting standards. The
concern is whether conventionally prepared financial statements provide factual and up-to-date information about a firm's financial position and performance. If the information is date specific then it needs to be current, but conventional financial statements are prepared on a basis of costs pertaining to the past.

2.3.2 Accounting Practice Legitimized by Attestation of Auditors.
The application of generally accepted accounting procedures has been endorsed by auditors during this century, although they do not certify that the content of financial statements is 'true and fair'. Auditors express an opinion on whether the statements 'fairly present' the financial position of a firm as at a certain date in compliance with applicable accounting standards. The terms 'true and fair' and 'present fairly' are interchangeable according to current auditing requirements. 'To express an opinion on the fairness of the presentation, the auditor uses either of two phrases that have equivalent meanings: "give a true and fair view" or "present fairly".' Auditing Handbook (1993, p47)

'There are several reasons why the auditor cannot guarantee absolute accuracy of the financial statements. These are attributed to, first, the nature of the financial statements themselves and, secondly, the nature of the auditor's function.' Financial statements are a '...mixture of recorded facts such as cash at bank; accounting conventions such as use of the lower of cost or net realisable value rule for inventory valuation; postulates such as the going concern postulate...and personal judgements applied to estimate the provision for doubtful debts or select the method used in calculating depreciation of fixed assets.'

Gul, Teoh, and Andrew (1991, p532)

Arguably, the function of auditing may be impossible to achieve given the complexity of
the content of financial statements, or it may be that auditors are lacking tenacity, by failing to establish a firm's financial capacity to continue trading. Wolnizer (1987, p183) stated 'The function of auditing is the independent authentication of dated accounts of the financial position and progress of firms.' Emphasizing that dated monetary amounts are necessary financial details when ascertaining the ability of a firm to continue operating within the market. 'The objective of the financial statement audit is to add credibility to management's financial statements.' Auditing Handbook (1992, p26) The degree of credibility the auditor's report adds to financial statements is questionable however, when the financial statements do not provide users with details of a firm's financial position as at the date of the statement. Evidence of a firm's financial capacity to continue to trade needs to be established at each audit, and reflected in periodic financial statements. This is the single independently verifiable general conclusion that accounts could reflect and currently do not.

2.4 Defects of the Conventional Going Concern Notion.
Financial statements based upon an untested assumption are fundamentally defective and the content of such statements deficient, because they do not contain evidence of trading strength; that is, a firm's ability to pay its debts, buy and sell goods and services, change product/s supplied to the market in response to changes in consumer demands, or rearrange its structure to produce a more effective business enterprise. Chambers and Wolnizer (1990, p355) said '...what a firm may be able to do or may choose to do at any time is conditioned by the composition of its assets and debts.'

Periodic financial statements are supposed to convey useful financial information on a business to interested parties. Conventionally prepared financial statements may provide true or false impressions of the financial status of a firm. Assessment of a firm's capacity
to trade as at a certain date is surely fundamental. A dated financial truth, as opposed to
an arbitrary allocation which has no commercial referent, is an independently verifiable
fact. The notion that factual and useful financial information should be periodically
provided to users has been a recurrent theme in the accounting literature.

'Any general impression clearly conveyed by the statements should be a true
impression. The statement, though technically correct, should avoid creating a false
impression in the mind of the reader.' Sanders, Hatfield, and Moore (1938, p21)

'The principal purpose to be achieved by the collection of accounting data...is to
provide useful information for the evaluation of past business decisions and of
methods used in reaching those decisions.' Edwards and Bell (1961, p271)

'The essential requirements are, first, that a statement be presented showing the
status of the company at the end of the accounting period...'
Moonitz and Jordan (1963, p521)

'...both the responsibilities and objectives of the modern large corporation are such
that appraisal of their status and progress must be based on current values.'
Ladd (1963, p44)

'The fundamental objective of accounting systems and of financial reports should be
to satisfy the needs of users for financial information on the economic affairs of a
firm.' Barton (1982, p6)

The quality and usefulness of financial information is determined by its relevance,
reliability, and verifiability at the stipulated date. Historical financial details may provide
information, but that information only has relevance for the user of the statement if the
related dates are also supplied. Information concerning the economic status of a firm and its potential to transact business into the future must be current so as to provide a reliable and independently verifiable base for decision-making. '...emphasis has been on the objectivity of the statements of the system, the requirements that they shall be commonly interpretable, whatever may happen to be the viewpoint of the interpreter.' Chambers (1966, p280)

2.5 Conclusion.

Conventional accounting wisdom accepts the view that a firm is a static entity with an indefinite life. This idea emerged in the twentieth century with increased investment in durable goods during the nineteenth century, which subsequently resulted in the problem of how to deal with depreciation of durables over a period of time. The conventional 'going concern' notion provided a rationalization for the (arbitrary) spreading of costs across a number of accounting periods and justification of procedures like the matching of current costs with expected future revenues and depreciation of assets at a predetermined rate.

The use of these methods in compiling a firm's periodic financial statement means the statement includes a mixture of monetary estimates, speculations, and operating results derived by formula. This does not provide investors, creditors and other interested parties with up-to-date facts concerning a firm's financial capacity to continue trading and survive in the market. Financial details such as dated solvency, dated debt to equity relations, dated rates of return, all contribute to the combined conditions that ensure a firm's survival as a 'going concern'. These are effectively ignored in conventionally-prepared accounts.
Financial statements based on an untested assumption that a business has the financial capacity to continue operating into the future has been questioned over the years by a number of writers. One idea raised by Fremgen (1968) was that business continuity needed to be established by supporting evidence of the fact. Other accounting authors favour an alternative view to the conventional 'going concern' notion, that of a business as a dynamic entity within a changing world. The following chapter pursues this line of thought and discusses economic behaviour in relation to the firm and its capacity to trade.
CHAPTER THREE

ECONOMIC BEHAVIOUR

'...profit maximization is a useful assumption in understanding the firm's behaviour. Firms that make losses cannot continue in business indefinitely.'

Begg D., Fischer S., Dornbusch R. (1984, p110)

The essence of the conventional accounting notion of a 'going concern' was explained in the previous chapter, but an alternative view has been advanced by authors like Chambers (1966) and Sterling (1979). Their idea is that firms adapt to changes within the market and do so within the normal course of business.

'A going concern is a firm which adapts itself by the sale of its assets, short-term and durable, in the ordinary course of business; that is, a firm which is not in the process of forced liquidation.' Chambers (1966, p218)

'If the technology of production changes, an owned asset may have to be replaced with an unowned asset in order to meet the competition. If relative prices change, an owned asset may have to be replaced with an unowned asset in order to minimize costs, that is, to substitute one kind of capital for another kind or even substitute labor for capital. These decisions are not merely theoretical niceties. Firms regularly make such decisions since they must adapt to changing conditions.'

Sterling (1979, p121)
Various aspects of a firm and its business operations that highlight the difference between the conventional accounting view of a static organization and the alternative idea of a dynamic trading entity within the economic environment are discussed in this chapter. Areas covered include a firm's ability to invest and attract investment, economic strategies, tactics, behavioural aspects of business entities, and the factors associated with a firm's financial capacity to trade.

3.1 The Firm and Investment Opportunities.
A firm is a trading entity which engages in the buying and selling of products or services, and may operate as a sole trader, partnership, private or listed company. Goals and objectives of the firm include business operations aimed at achieving an increased market share for a new or improved product, profit maximization, solvency and financial flexibility, or a combination of these and other factors. Economic environmental conditions alter from time to time as do the expectations of individuals and firms trading within the market, and these factors affect the firm's financial capacity to trade. Market changes occur in response to economic and political developments on a domestic and international basis. To ensure continuity of business operations firms react to changed circumstances within the market as well as altering operating procedures and strategies according to their own initiative.

Investment decisions are crucial to a firm's survival and growth potential. Investors in a firm expect a benefit for their financial support either by way of dividend payments or capital gain, and may change their investments if not satisfied with the rates of return or growth achieved. The ability of the firm to maintain market share, exhibit growth potential, sustain positive operating results and other achievements that may be related to effective management performance, increase the firm's likelihood of attracting further
Financial support from the market tends to increase when the rate of return for investors increases. This increased rate of return may be associated with increased debt and financial risk. '...risk is a key component of investment decisions, but evaluating risk precisely remains an art and not a science.' Jones (1991, p150) A firm’s management encourages investor support in the business by presenting the entity to the market as a promising investment opportunity.

The market in turn considers management performance, the firm’s operating results, industry status and capacity to meet future challenges as they arise. Investment opportunities emerge in and disappear from the marketplace. Each firm as an individual entity competes for a share of available investment funds.

3.2 Economic Strategies and Tactics.

'A business organization exists in a changing environment. Innovations in technology, social values, consumer behaviour, economic conditions, politics and even pollution standards, all create environmental threats and opportunities that may be important to a company.' Mukhi and Potts (1982, p3)

Managers plan strategies and develop tactics that assist them in gaining a competitive advantage over other firms within the same industry or across industries. Subsequent action taken by managers needs to be timely and may include the introduction of new products and services in anticipation of a change in consumer demands. Firms seek product differentiation to be easily identified from other suppliers, provide consumers with
a choice of products and secure a market share. '...the decision-maker must systematically and creatively search for a range of possible options from which a set of alternative courses of action [or strategies] can be determined for consideration in a particular context.' Moore and Thomas (1984, p40) Product changes may result from market surveys conducted by the firm or management speculation associated with the likelihood of an increase or decrease in consumer income due to current economic conditions, a boom period or a recession.

Firms use various forms of advertising to convey information about product availability to consumers and to persuade them to buy one product in preference to another. Management may concentrate on producing superior quality products for sale in the market at relatively high cost to the firm, to establish a trading niche. Subsequently, to ensure an adequate cash flow and access to cash managers might supplement total earnings with short term or long term borrowings, or the sale of assets. Increased costs incurred by the firm may be passed on to consumers in the price of the goods. Such decisions related to the pricing of saleable products are part of competitive tactics and a firm will not successfully trade goods the market considers to be overpriced and this will affect management decisions. A firm can benefit from a flexible price range where it adjusts commodity prices to better suit its current needs and those of consumers. Prices may be reduced to a point where only the variable costs to a firm in producing the product are covered, or a firm may choose to incur a loss for a short period in order to establish a customer base or gain an increased market share over a competitor.

Factors that affect the supply of products and services to the market and their subsequent price include current consumer demands, a firm's response to technological advances, trading activities of competitors and changes in government regulations. A firm might choose to diversify its business interests to gain a larger share of the available market, to
reduce its production or distribution costs, or expand its trading activities into a new area. Such action reduces a firm's business risk associated with trading in a particular industry and helps to increase competition and efficiency among other firms. When firms enter an industry existing firms accept the situation and adjust to new challenges or choose to exit the industry.

3.2.1 Production and Distribution.

All conditions associated with the production and distribution of goods are volatile under the influence of other entities operating within the market. Firms collectively draw on available but limited supplies of labour, materials, services, cash and credit. They compete for these factors of production and for consumer favour. Simon (1976, p114) stated ‘...organization objectives are adapted to conform to the changing values of customers, or to secure new groups of customers in place of customers who have dropped away.’ Profits are affected by the choices consumers make about available products and services, and these choices are influenced by competitive tactics employed by firms within the market as well as prevailing economic conditions.

The amount of debt a firm carries usually influences its capacity to compete with other entities in the market. A business dependent on debt finance to maintain operations needs to cover increased expenses incurred as interest charges on the borrowings, and any subsequent movement in interest rates. The level of debt can therefore affect the entity's capacity to produce and distribute goods. If this effect is strongly adverse the firm's capacity to keep pace with competition is impaired and growth potential of the business is likely to decline. These considerations require management to have up-to-date knowledge of the firm's liquidity position and on a broader scale the capacity of its assets to cover debt obligations when due. Such information assists management in planning business
procedures and trading opportunities for the present and future, because the current
financial status of the firm in relation to its economic environment and present
commitments can be ascertained.

3.2.2 Competition and Communication
Firms generally have many departments; personnel, production, accounting, marketing,
general administration, and interaction between these departments and external entities
are part of normal business operations. Managers requiring financial information to assist
in business decisions during a specific period need current financial details to keep abreast
of everchanging economic circumstances. Swings in consumer demand need to be dealt
with in a timely fashion to ensure the firm remains competitive with other suppliers in the
market. Effective communication is essential to benefit from trading prospects as they
emerge.

A firm consists of various divisions and each division competes with the other, in part for a
share of corporate funds; the division's operating performance may be measured by its
contribution to the firm's overall profit figure. Divisions may be considered autonomous
profit centres which operate virtually as entities separate to the firm, or divisions may be
responsible for acquiring a certain profit margin but may not have the right of
self-government. Other divisions may be cost centres where management accountability
extends only to periodic expenses.

Consider a firm with several autonomous divisions which supply, manufacture and sell a
variety of products. One division supplies the market with an item that a second division
within the firm uses in the production of a machine, subsequently sold through retail
outlets of the same firm. The machine part required in the manufacturing process
performed by division (X) may be supplied by division (Y) but is currently purchased from an outside supplier. If the divisions are profit centres they may choose to trade with each other but to do so need to agree on the price that division (X) will pay division (Y) for the required part, as both divisions of the firm want to secure a profitable deal. In this case division (Y) would compete against other market suppliers to sell the manufacturing division the component used in the production process.

If division (Y) cannot make and supply the necessary part at a competitive market price the divisions are unlikely to trade, because if they were to enter an agreement (with division (Y) supplying the part to division (X) at the market price) it would adversely affect the profits of division (Y). In such a situation corporate management may choose to intervene and insist the divisions trade with each other because the profitability of the entire firm would be increased, but this would affect the self-governing rights of the divisions. If divisions are autonomous corporate management leave operating decisions to the divisional managers and do not interfere. There are many associated cost and behavioural factors to consider in such an example and the alternatives need to be carefully weighed, for example:

Alternative 1
Division (X) chooses to continue purchasing the part from the outside supplier. There may be a discount offered for prompt payment or bulk purchase.

Alternative 2
The firm decides that all divisions must trade internally to maximize company profits and produce a high quality product.
Alternative 3

Division (X) may choose to increase production capacity for its saleable product, thereby increasing the number of purchased parts required. The choice may then be to continue purchasing the original number required from the outside supplier and manufacture the increased number internally.

Other alternatives may be relevant depending on the existing set of circumstances. The manufacturing division as an independent entity would act according to its wants and needs, specifically in relation to expectations of profit and known debt obligations. Purchase of the part from division (Y) would depend on a number of factors such as quality of the product, price, dependability of the division as a supplier in comparison with external suppliers.

In contrast to the previous example managers of cost centres are only responsible for the expenses they incur during a particular accounting period. The manager may have considerable input into budget preparation as he/she has the responsibility of acquiring the necessary funds to operate the section for the benefit of both the cost centre and the firm. Competition between these divisions extends at least to securing an adequate portion of any available funds.

Subsequent allocation of funds depends upon the amount of moneys currently available to the firm for use in daily operations. Management require knowledge of cash amounts obtainable in liquid and convertible forms, which can be used as working capital after present debt obligations have been covered. Circumstances change and operating procedures are continually revised as emerging conditions require new approaches. Management need to be continuously apprised during any accounting period of the liquidity position of the firm and its various divisions and its financial capacity to continue
trading.

3.2.3 Information versus Relevant Information.

Providing management with reports on a frequent basis does not necessarily enhance the quality of decision making. Qualitative and quantitative information in management reports must be relevant to the decision at hand. In particular, information that is pertinent to financial choices generally and an assurance that details presented are current, relevant and reliable.

The usefulness of accurate and timely reports to management depends on information contained, whether it is pertinent to the current situation and not cluttered with irrelevant or confusing details. Beer (1975, p34) remarked on confusion associated with "information overload":

A general levy is a low variety tax, and therefore easy to administer.
Once we take account of individual circumstances, the variety goes up.
But we can still cope as long as people are more—or—less the same. But technology has moved in...The individual citizen has found more and more things to do, and this proliferates variety in his tax affairs.
If he deliberately obscures this situation, he is injecting yet more variety into the situation. In trying to match this variety, more and more regulations are introduced — until it is doubtful whether anyone can work out what is happening.

The importance of communication and the controlled flow of relevant information can be explained by cybernetics. "...defined with unique clarity and authority by the late Norbert Wiener to mean "the science of control and communication in the animal and machine."", Beer (1975, p105)
Volatile market activity means that managers need current information about consumer demands on the available supply of products and services, to assist decision-making in the normal course of business. Prices of raw materials and other goods related to the provision of marketable commodities reflect current economic and competitive conditions, and a firm’s capacity to meet payments due depends on the firm’s current financial situation. ‘Cybernetics or steersmanship, [is] what managing is about. And that depended on continuously up-to-date information.’ Chambers (1966/1974, pvi)

The quality and usefulness of financial statement content for decision making purposes may be questioned because the monetary amounts generally used are not of the same kind. The statements reflect a mixture of estimates, concepts, subjective judgements and postulates. ‘...some of the important terms used in financial statements are simply jargon and others have a multiplicity of meanings, when no figures except perhaps cash and long-term debt have unequivocal and therefore understandable meanings and no totals therefore have a sensible meaning...’ Chambers (1969, p241) Financial information at a certain date is time specific and so the content of dated financial statements must relate to the date specified to be in fact accurate, reliable information on the firm’s financial position.

3.3 Adaptive Behaviour of Business Entities.

Economic behaviour is adaptive behaviour. ‘...a broad class of facts which may be described as economic...are four types of human activity...production, consumption, utilization, and exchange.’ Boulding (1955,p3) The firm’s ability to respond quickly to new and developing circumstances within its trading environment depends on its capacity to use available resources. A firm may expand business operations in an attempt to increase company profitability, pursue investment opportunities, or perhaps decrease reliance on external suppliers. Opportunities for company growth and increased earnings could be lost
if all relevant details are not given to decision makers and a major requirement is knowledge of finance available to cover costs of proposed projects.

3.3.1 A Matter of Choice.

'...the economist is chiefly interested in the role of costs and profits as determinants of the firm's supply decision...Opportunity cost is the amount lost by not using the resource (labour or capital) in its best alternative use.'

Begg, Fischer and Dornbusch (1984, p118)

Firms may choose to enter and stay within an industry competing for market share if goals and objectives are seen to be achievable and trading results are satisfactory. Conversely, firms may choose to quit an industry resulting in the reduction of certain goods and services to the market. The entry and exit of firms to and from an industry will ultimately affect the market price of relevant goods and services. As supply increases the market price is likely to decrease and as supply decreases, when a firm exits the industry, the market price is likely to increase. Product price variations will affect product demand because consumers ultimately choose the product that maximizes their satisfaction at the lowest available price.

Choice is a part of normal daily routine for individuals, groups and business entities. When an individual chooses to purchase an item it is necessary to know the buying price of the desired product and whether the funds required are available to the individual to complete the transaction. The outcome rests on whether the parties involved in the transaction are prepared to exchange the nominated money amount for the desired item.
Boulding (1955, p6) provided the following example 'We observe there are two physical objects involved. One is the butter, which passes from the possession of the storekeeper to Mrs Jones. The other is the $1.60, which passes from the possession of Mrs Jones to the storekeeper. An exchange, therefore, consists of two reciprocal transfers of ownership.' The housewife will change her decision to purchase the butter if she perceives that another product at a lower price will provide equal satisfaction. However, this decision will be reversed at a later date if her expectations regarding the cheaper product are not satisfied. So the housewife's purchase will depend to a large extent on comparing her preferred choice against how much money she has to spend on the product.

3.3.2 Expectations and Behavioural Change.

Economic literature examines expectation theories and strategies involved in policy and decision making. Three ideas that illustrate behavioural change in relation to the economic environment are static expectations, adaptive expectations and rational expectations. A static situation implies a stillness, an unmoving state, but this quiet, unpressured steadiness does not depict a trading environment. Shaw (1984, pp 20,25) remarked, '...the static expectations hypothesis is tantamount to assuming that the economy has achieved a steady state equilibrium.', and 'The doctrine of adaptive expectations simply implies that economic agents will adapt their expectations in the light of past experience and that in particular they will learn from their mistakes.' This theory emphasizes past situations and future actions are considered to be determined by those past circumstances. A firm that does not have factual and up-to-date financial and other market-related operating information is at a disadvantage in a competitive environment.

A rational expectation '...assumes that individual economic agents use current available and relevant information in forming their expectations and do not rely purely upon past
experience.' Shaw (1984, p47) 'This notion suggests a major difference in economic thought from conventional accounting, in so far as economics acknowledges the dynamic nature of the environment and firms trading within the market, and conventional accounting rationalizes the use of the assumption that a firm is a static entity when compiling financial statement information. 'Trading firms are no less adaptive entities than are persons as such. Whether their expected span of existence is short or long, the expectations of constituents may only be satisfied if their modes of operation, and their particular operations, are such that they take advantage of their resources in the environmental conditions as they prevail from time to time.' Chambers (1965, p190)

Behaviour is a process that is learned from birth and develops thereafter. Economic behaviour may be learned through the process of formal teaching, environmental experiences, or both. A student who has thoroughly learned and can apply certain skills necessary to perform task oriented procedures has achieved the ability to practice indoctrinated techniques. The difference, however, between a technician per se and a technician with an enquiring mind is that the former will habitually practise what has originally been taught and the latter will question the relevance and correctness of what is being done. 'Genuine decisions...require the perception of a new situation and the solution of the problem raised by it; they lead to responding to a situation in a new way...habitual behaviour is rather common. We do what we did before in a similar situation.' Katona (1963, p49)

'Habit must not be thought of as a purely passive element in behaviour (either individual or organizational), for once a habit has been established the mere presence of the stimulus tends to release the habitual behaviour without further conscious thought. Under such circumstances, it may actually require conscious attention to prevent the response from occurring even if changed circumstances have
made it inappropriate.' Simon (1976, p89)

3.4 Financial Capacity to Trade.

Business entities require an adequate cash flow and access to cash to continue trading, to ensure liquidity and the ability to implement flexible operating procedures. Consequently, managers need financial details related to the properties of the firm in terms of current market prices. The relationship between accounting for a firm's periodic transactions and the results of its financial transactions has been explained with reference to progress in earning profits and maintaining solvency. That is, balance sheets were based on observed asset prices, but this altered during the nineteenth century when the idea of cost allocation mainly in respect of durable, depreciating assets began to be endorsed.

The result has been that in practice the discovery of up-to-date asset prices ceased and controversy over the valuation of property has been perpetuated.

Holmes and Sugden (1990, p169) remarked,

'...we believe that the accountancy profession will continue in disarray and that HC [historical cost] accounts will continue to lull many managers and shareholders into thinking that their companies are doing considerably better than they really are, and will continue to encourage unions and employees to seek wage increases that are not justified by real (as opposed to reported) profits.'

Current financial information that depicts an inflow of cash to the firm assists the decision making process, because it provides up-to-date monetary equivalents of assets held by the firm. In contrast, a firm's financial results based on arbitrary allocations and valuations made under the conventional accounting system do not provide decision makers with financial information on the current debt to asset status of a firm.
'A prudent man in the management of his own property would be concerned with any rise
or fall in its price by comparison with cost.' Chambers (1955, p13)

3.4.1 Accounting Procedure or Functional Fixation.

'To judge by public curricula, relatively too much emphasis is given to routine
accounting procedure and too little to substantive problems with which the student
will have to deal as a principal when he is ten years out of school.'
Canning (1929, p329)

Functional fixation is a psychological term which conveys that a meaning or understanding
is attached to the use of language or methodology and alternative approaches are then not
acknowledged or seen. 'The application of functional fixation to accounting began with
Ijiri, Jaedicke, and Knight's discussion of the conditions under which a decision maker may
be unable to change the decision making process in response to a change in the underlying
accounting process that provided him or her with the data.' Belkaoui (1981, p89)
Functional fixation with past experiences occurs when individual perceptions attribute a
value like a particular quality, or monetary equivalent to an asset, instead of promoting an
awareness that as time passes changes occur and action may be required in response to
those changes. Items and their values tend to change over time, situations alter as time
passes, and individuals respond by adapting to the demands of the current situation.

The procedures for determining monetary amounts on the balance sheet are varied under
conventional accounting. Cash on hand is a factual amount about which there can be no
argument. Debtors are a reliable source of cash only when known to pay, otherwise the
potential short term asset becomes a doubtful asset which may become a bad debt, a
subsequent loss to the firm. Inventories are a firm’s major asset and yet the reported amount may be determined in various ways, as the accounting standards provide four methods for inventory valuation.

In a manufacturing organization inventory items may undergo many changes (some saleable and some not) before the production process has been completed. ‘Because most manufacturing processes are continuous, it is therefore likely that, at any given point of time such as the end of an accounting period, a manufacturer will be holding several different categories of inventory...’ Harrison, Horricks, Newman (1977, p465) Inventory held by a firm will have a factual monetary equivalent if a market exists for its sale. Otherwise its value to the firm will be of an intrinsic nature, as part of the manufacturing process to attain a saleable product. At any point in the manufacturing process where inventory has no general market for exchange it has no ability to generate cash for the organization, and as such cannot be converted to a monetary equivalent to assist in covering debts due, or providing cash if necessary for continued business operations. ‘The goods have no opportunity cost. There seem, therefore, to be grounds for assigning no current cash equivalent to them.’ Chambers (1966, p243)

3.4.2 The Exchange of Goods.

Information necessary to the successful completion of any business transaction includes knowledge of the required amount of money. Regardless of other determinants, it is essential for the involved parties to know the amount in current money terms for an agreed exchange to take place. ‘The exchangeability of goods, services, and capital is measured in terms of money.’ Belkaoui (1981, p222) A successful sale mainly depends on whether the purchaser has the money to pay for the item and the seller wants the money more than he wants to keep the item. The process of being satisfied and satisfying others is continuous,
as is the everchanging state of financial position whether it be related to an individual or a corporation.

The market is an exchange centre where consumers and distributors continually strive for satisfaction, where individual and corporate wants and needs change over time. 'Changes in financial position are continual; changes in the state of satisfaction are continual; adaptation or its pursuit is a continual process, or, more strictly, a continuous cycle of processes.' Chambers (1966, p124)

3.5 Conclusion.

Adaptive behaviour is economic behaviour. Trading firms adjust their business operations to meet the challenges of the economic environment which result from continually changing circumstances. For a firm to implement flexible business operations an adequate supply of available cash and cash equivalents is necessary. Business entities continually compete for an increased share of the market and divisions within the entities compete for a share of available funds to ensure continuing business operations.

Accounting, economic, and behavioural references have been used to stress the commonality of the concept of adaptive behaviour. In accounting this concept is not new but it does not form part of conventional accounting practice. It is, however, prevalent in economic thought and inherent in the normal daily routine of individuals and firms. Accounting procedures which report the effect of changing conditions within the market on the financial position of a firm and its subsequent capacity to trade, would make management's task easier.

Evidence that business firms are dynamic entities is provided in the following chapter.
Four major Australian banks are the focus of investigation and a variety of illustrations are given which provide evidence of adaptive behaviour in the normal course of business in line with economic theory.
CHAPTER FOUR


'...every organization is continually undergoing the test of new demands, the test to see how these new demands conform to existing policy and, in general, pushing the policy toward new dimensions. In some sense, therefore, the goals of the organization are never completely consistent at any particular point in time.'

Cohen and Cyert (1965, p331)

Evidence of flexible and dynamic business operations in relation to four major Australian banks during the period following deregulation of the Australian financial industry is provided in this chapter. The facts support the protestations of the previous chapter that economic behaviour is adaptive behaviour and is currently part of normal business operations. Banks, which are generally viewed as conservative entities, are shown to be forceful in their pursuit of financial market share, international growth prospects, and subsidiary business opportunities.

A major aim of financial institutions is to provide the market with competitive financial products and services. Saleable items include such facilities as payment services (automatic teller machines and electronic funds transfer), foreign exchange services, financial advice, a variety of loan products, business cards, and deposit accounts. Allocation of funds throughout the community are mainly determined by such financial factors as risk associated with business ventures and the expected return on investments. Level of efficiency and effectiveness attained by a financial institution in daily operations
may be decided by the extent that needs and demands of the financial market are satisfied.

In 1937 the Royal Commission on Monetary and Banking Systems advocated that depositors' funds should be protected by the central bank. The Commission thought that a single bank failure would put stress on the entire financial system. This was the first move to regulate the financial industry. Other restrictive policies directly related to the effects of war were imposed during 1939 and 1945, and subsequent banking regulations administered by monetary authorities remained in place until the 1970s.

Regulations protected the banks from internal and external competition, and provided the central bank with monetary policy instruments that could be used to manipulate the flow of funds throughout the community. These regulations included interest rates paid on deposits and charged on loans, foreign exchange controls, controls on asset composition (minimum number of Commonwealth Government Securities were required), and special reserves had to be placed with the central bank. 'Taken collectively, these regulations seriously impeded the capacity of the banks to meet the emerging needs for financial services...[and]...allowed the authorities to influence the allocations of funds by banks to priority areas...'

Hunt and Terry (1993, p403) Interest rate limits on bank deposits reduced associated risk and resulted in stable profits but also hindered banks in competing for those deposits.

As a result of inflexible operating procedures, non-banking financial institutions arose to service the dissatisfied market. Banking regulations mainly promoted growth of the non-banks and repressed the growth of banks. Competition continued to take advantage of financial opportunities and so the ineffectiveness of direct controls (regulations) on the banks became evident, particularly during the 1970s with the global development of the financial system.
Deregulation of the financial industry removed the restrictive practices which had caused obstructions to effective financial operations. The Campbell Committee formed between 1979 and 1981 to inquire into the Australian financial system seemed 'to be an important point in the approach to deregulation, [but] it is possible that the removal of financial regulations was inevitable.' Hunt and Terry (1993, p405) The banks and the financial community in general wanted flexibility to expand business operations, and to compete with non-bank institutions in the financial services industry.

During the period 1980–1983, the ceiling on interest rates paid on bank deposits was removed, the Bank of New South Wales and the Commercial Bank of Australia merged, National Australia Bank merged with the Commercial Banking Company of Sydney Ltd, a tender system for treasury bonds was introduced, the Australian dollar was floated (to improve control over domestic liquidity), and most exchange controls were abolished (to allow freer capital flows in and out of Australia). In 1984 the Martin Review Group released a report recommending the continued process of deregulation. (See Hunt and Terry 1993, pp407,408).

The previous asset growth of non-banking financial institutions was now reversed with banks becoming a dynamic force within the industry. Major banks retained a dominant role, smaller banks tended to lose market share and were sometimes absorbed by larger banking groups. Competition increased as new foreign banks entered the market and innovative ways were devised to ensure a competitive advantage in this new and challenging financial environment.

Evidence is presented in this chapter that business entities which are demonstrably 'going concerns' in the sense that they have the financial capacity to adapt to changing markets and market conditions, are not 'going concerns' in the conventional sense. This study is
concerned with the nature of, and change in the Australian banking industry generally, and with the business operations of the four major Australian trading banks in particular; namely, the National Australia Bank (hereafter the NAB), Commonwealth Bank of Australia, ANZ Banking Group, and Westpac Banking Corporation.

While banks are usually regarded as being 'conservative' institutions it is shown that these banks are flexible organizations and alter business operations from time to time for a variety of reasons. Information published in the banks' annual reports for the period 1983–1991 has been examined, and observations that illustrate some of the changes to banking operations during this period have been documented. In particular, changes in the following activities are discussed: Products and services, loan services, acquisitions, sale of property, non-core banking operations, and international banking.

4.1 Products and Services.

The four major Australian banks expanded operating procedures in various ways including their product and service range, and this section examines some of those changes during the period under review. The core activity of banking in Australia relates to the provision of financial and associated services to consumers through a branch network, and the banks sought a competitive advantage to retain and increase their customer base by improving and expanding these activities within the operating environment.

4.1.1 Products

In 1983 the NAB repackaged personal loans as specific purpose loans, for example home improvement loans; car loans; multi-purpose loans. They also introduced a new cheque account product called a 'Premium Package' which paid market interest rates and included a range of other benefits such as travel advantages, credit cards, finance, and in 1984 a
range of short term deposits for customers were available.

The Commonwealth bank at this time introduced a new term deposit account, Excel—A—Rate, giving customers the option of withdrawing funds without penalty at three month intervals, or yielding the benefit of an increasing interest rate with continuation of the term. Other initiatives included personal credit line (which allowed an increased repayment period), a plastic card based product called 'Club Australia', and an approved deposit fund.

The ANZ banking group (1984, p11) reported '...perhaps the greatest change ANZ is having to manage relates to the culture of the organization from working in a regulated environment, we now face the reality of being market responsive in a truly competitive industry.' On February 6, 1984 the bank released the ANZ Visa Card, a new product to further expand their customer base in the credit card market. In August the same year they introduced new deposit products and increased customer choice in relation to term deposits and interest rates offered for retail and wholesale clients.

Westpac and American Express jointly issued the Goldcard during 1983 and Westpac also developed an affiliation with Mastercard International Incorporated. The introduction of these products increased service to customers through the provision of a combined debit and credit facility with Mastercard and the wider access to the Handybank network. During the following financial year the bank introduced two new package products, Getting Started — which is primarily designed for school leavers and, Altogether — a package to assist families with money management. Westpac also introduced two new funds, Westpac Real Property Growth Trust and an Approved Deposit fund.

During 1985 the NAB introduced, interest bearing cheque accounts as part of product
packages; variable repayment loans for housing finance to expand housing loans; developed factoring operations; property finance; and enhanced a range of products in the areas of inventory finance; equipment purchase finance, working capital advances, and international factoring. The Commonwealth bank at this time focussed on the small business sector and introduced a specially designed loan facility for small businesses. Other new products introduced through to 1986 included a short term call account, settlement deposit trust account, new statement savings account, loan protection insurance, and a mortgage fund.

During 1985–1986 the ANZ banking group developed and introduced new or enhanced products like 'Fast Forward', an account aimed at the under 25 years market; a high interest at call account for primary producers named 'Harvest Account'; ANZ high performance passbook, a high interest passbook savings account; and ANZ home savings bonds. In October 1986 the bank released a high performance account updating the traditional passbook, and later introduced the Visa Premier Club.

The ANZ bank then introduced ANZ Master Trust, marketed as a total investment system, and a superannuation pool for trustees and fund administrators. ANZ also embarked on a reciprocal agreement with the Hospital Contribution Fund of Australia, where the bank sold HCF health insurance and accepted premiums through their branch network, in exchange for HCF selling a variety of ANZ products to its customers. In May 1987 ANZ released the Visa credit charge cheque, an alternate way to access the Visa account. The Commonwealth bank introduced a security plus package to extend the security plus investment account, and developed a new package called 'Essentials' that was specifically aimed at the 18–24 year age group. During 1986–1987 the bank changed the product 'Club Australia' which had been initially introduced in November 1984 to target young high school students, and in January 1988 the bank introduced the Dollarmite primary school account.
NAB introduced a term lending product at this time which had repayment options and a range of available interest rates. The stockmarket crash of October 1987 resulted in an increase in demand for residential and commercial investment properties. The NAB responded to this change in market demand by releasing new products during 1988 such as the rewards retirement package and a flexi-plus mortgage account; the latter being an overdraft borrowing secured against the residential property.

Westpac annual report (1988, p8) stated ‘Westpac has moved progressively to offset, and then take advantage of, global developments in financial markets. In response to deregulation, the Group has grown rapidly beyond its traditional base to expand into new products and new markets.’ In October 1988 the bank introduced credit card insurance for its customers, and made available to selected customers in Australia and New Zealand an owner occupied residential mortgage based line of credit called Westpac Equity Access. In addition, Westpac simplified its Australian product range and released the ‘Advantage Saver Account’ as the principal deposit product. Transaction charges were also introduced at this time and the Westpac traditional passbook account was withdrawn from sale.

During the two year period 1989 to 1991 NAB released six new products onto the market including fixed rate housing loans, mortgage trimmer plan, new cash management deposit account, and the mastercard business card. The Commonwealth bank developed a medium term note program and reviewed and upgraded deposit products; for example, a cash management call account for small to medium sized investors, and a mortgage interest saver account. The bank responded to the changing demands of the market and acknowledged this in its annual report (1989, p14) which stated ‘Analysis of the change in the pattern of banking in Australia over recent years has shown that accounts previously used for savings are now often used purely for transactions.’ The bank’s response was to introduce a fee on passbook and keycard savings accounts with balances less than $250.
Other new products included a loan facility for residential property investment; a rollover bond; trade finance packages; a flexible multi-function account, 'Streamline'; and a pensioner security account. An affinity mastercard programme with the Spastic Centre of N.S.W. was introduced in March 1990 and during the 1989–1990 year the bank produced the Commonwealth Mastercard Business Card.

ANZ introduced their Mastercard as an alternative to Visa card during 1990–1991, which increased the variety of credit cards available on the market and further expanded the ANZ credit card customer base. The previous year ANZ launched the Visa business card which was to enhance the already available Visa classic and ANZ premier cards. Additional product enhancements occurred when the bank established the ANZ bankcard as a debit and credit card account; altered the ANZ access account to include a cheque issuing facility; and introduced a variety of home loan packages, for example, the residential investment property loan. During the financial year 1990–1991 ANZ also redesigned the 'Access Account' and 'High Performance Passbook' to include daily calculated interest, paid quarterly, effectively increasing the monetary return to depositors.

4.1.2 Services

Banking services include such facilities as automatic teller machines (ATM), electronic funds transfer at point of sale (EFTPOS), and interchange arrangements between banks and their agencies. In 1983–1984 the NAB had 209 operational flexi-teller machines at street front locations of some branches, and off premise machines were being installed at various railway stations and shopping centres. By 1990–1991 the NAB had 772 flexi-teller machines Australia wide, and had established 4,641 EFTPOS terminals across the country in a six year period.
Growth in the electronic banking facilities for the Commonwealth banking group during this period developed from 111 autobank terminals in 1983–1984 to a total of 1,104 autobanks in 1990–1991, with the availability of 864 other automatic teller machines and 300 ‘Easy Banks’ that were State Bank of Victoria machines. EFTPOS was introduced by the Commonwealth bank in October 1984, and in 1985 the network was expanded to almost 1000 EFTPOS terminals, with agreements finalized to link the network terminals with other EFTPOS participants.

The Commonwealth bank also installed Electronic Funds Transfer at Point of Bank (EFTPOB) in association with Australia Post agencies on Queensland’s Gold Coast and some western suburbs of Sydney. By June 1987 EFTPOS terminals were expanded to provide access to more than 5,500 retail outlets, and EFTPOB terminals were introduced at agencies and post offices in April 1988. Electronic services expansion continued in July 1987 with the introduction of POSCASH, the cash dispenser linked to the EFTPOS network, and the following year the Commonwealth bank’s EFTPOS team established an electronic communications network for Caltex oil.

The Group introduced a Micro–Treasurer System during 1985–1986 which enabled customers to use personal computers for access to, and to process cash management information from, the bank’s mainframe system. Phonebank was introduced in April 1987, and in November of that year the Bank Interchange and Transfer System (BITS) was implemented, which reduced paper transactions and was a combined bank initiative between the major trading banks.

A debit card system and new generation keycard system was introduced which allowed customers to link bank accounts, and the bank expanded their foreign exchange capabilities, to cater for customer demand, with a 24 hour per day ‘Marketwatch’ service.
An automated letter of credit and clean payment system was installed to reduce 
turnaround time for international trade transactions, in the main Sydney and Melbourne 

ANZ established a pilot EFTPOS system in Australia and New Zealand during 1983–1984 
and by the end of 1984–1985 the system was operational in around 900 branches. The 
bank also introduced a corporate Videotex Information System, ANZTELL, in August 
1984. By December 1984 the ANZ automatic teller machine network had reached 
approximately 200 units nationwide, and during 1985–1986 ATMs were available at 295 
locations which was soon to be expanded. The NAB and the ANZ formed an interchange 
agreement reported in the ANZ annual report (1986, p12) which stated ‘...ANZ customers 
now have access to a total of 655 ATM’s soon to be expanded further by the addition of the 
State Bank’s Network.’ By 1987 the ATM availability had expanded to around 1,200 
locations throughout Australia, and in excess of 19,300 locations internationally through 
worldwide Visa system links. A new customer card service was introduced by the bank 

In 1983 Westpac handybank ATMs numbered 174 and during 1984–1985 had reached a 
total of 444, and the bank’s Handyway Point of Sale terminals (EFTPOS) numbered 1,022. 
By September 30, 1988 Westpac had 745 ATM’s and 2,530 EFTPOS terminals throughout 
Australia and New Zealand. During the next two years Westpac expanded its area of 
automated service to customers to over 4,300 Handyway EFTPOS terminals, and around 
900 Handbank ATM’s with access to a much larger number due to the link with the ATMs 
of the Commonwealth Bank of Australia.
4.2 Loan Services.

The changing attitude to financial business operations included a new approach to loan services. In 1983–1984 the Commonwealth bank reported an improved economic outlook, a decrease in interest rates and the introduction of the government's First Home Owners Scheme. The bank immediately sought to exploit a new opportunity to expand its home loan business by introducing new housing loans — the Home Seeker Loan and the Home Improvement Loan — the following year it introduced a new Step-by-Step home loan. By 1987 the bank was frequently changing its interest rates which enhanced their liquidity, and resulted in the development of a range of loan alternatives subsequently offered to customers. The range included terms up to 25 years repayable monthly (special repayments allowed), low start loan, high start facility, home seeker loan, fixed interest loan > $100,000 (3 year fixed), home improvement loan, land loan, 3 yearly review option, loan protection plan.

The ANZ banking group implemented internal changes in an effort to form a closer link between the bank and its customers, identify any potential problem accounts, and so improve the management of their loan book. Westpac's traditional trade financing activities expanded into medium and long term exports, and in relation to loan services the bank concentrated efforts in establishing a restrained credit policy. The bank's annual report (1985, p21) stated that policy was '...directed to the maintenance of high quality loan assets and a balanced portfolio to avoid undue exposure to any one country, region, industry, or company group.' The bank monitored their industry exposure on a regional and global basis and stated (1986, p8) that 'Studies of individual industries are conducted where concentration or economic changes indicate a need for close scrutiny.' The bank's overseas exposure to debt is mainly in those countries with a high credit rating and where Westpac's banking network operates; for example, in the United States of America; Japan; United Kingdom; other West European countries.
During 1987–1988 Westpac successfully attained the $1.38 billion defence service homes housing loan portfolio and increased personal housing loans. The following year the bank introduced daily interest calculations on loans, which acted as an incentive for prompt loan repayment. At this time the Commonwealth bank achieved a record figure in home loan approvals and attributed this increase to the availability of lower interest rates for customers. By 1989 the bank had introduced daily interest rate calculations on home loans, a procedure which was rapidly being adopted across the industry.

A tightening of monetary policy by the government resulted in the Commonwealth bank increasing their home loan interest rates to 17% by June 1989, and in October of that year the bank introduced a 5 year fixed interest rate policy. The ANZ had become more rigorous in their approach to lending applications, and concentrated on credit quality in relation to loan services. Westpac developed automated systems to assist managers in monitoring problem loans and stated in the annual report (1989, p13) 'The Group's lending portfolio has been examined rigorously to ensure that adequate provision has been made for bad and doubtful debts and priority is given to recovery action.'

The main emphasis for banks, after deregulation of the Australian financial industry, was on asset growth, including expansion of loan portfolios to achieve a greater size and so secure a competitive advantage. Commonwealth bank's annual report (1984, p11) stated 'Deregulatory changes and technological innovation increased opportunities for the entrepreneurial corporate banker.' During the late 1980s however, it became evident that a close scrutiny of potential loan customers, and a high priority on credit quality control was essential. Westpac's annual report (1990, p2) stated, '...placing controls on the previous rapid expansion of loan portfolios, [is] an important factor in stabilising asset growth.' The Commonwealth bank's annual report (1990, p15) stated '...residential property investment loan portfolio grew to $1.4 billion despite the bank's adoption of a generally cautious
approach, including tightening selectivity and security standards.¹

4.3 Acquisitions.

The four major Australian banks were also involved in expansion by acquisition during the period under review, which indicates a change in the corporate structure of the entities. The NAB purchased a 50% interest in A.C. Goode & Co. Ltd. choosing to enter the stockbroking market and stated in its annual report (1984, p15) that the company was ‘...a leading Australian sharebroker with representation in, all mainland states; London; New York; and Geneva.’ In October 1984 NAB also acquired a finance company, Beneficial Finance Ltd. in New Zealand, which subsequently operated as National Australia Finance Ltd. The Commonwealth bank entered the venture capital market when it acquired a shareholding in First MIC Limited, a management and investment company. During the financial year 1983–1984 the ANZ acquired Grindleys banking group, a diversified international bank; a 50% interest in McCaughan Dyson Co. Ltd., a stockbroking firm; the Development Finance Corporation Limited (DFC); the Australian Fixed Trusts Limited (APT), the main subsidiary of DFC; and the business of ANZ Executors & Trustee Co. Limited (ANZET). Westpac expanded their merchant banking interests at this time and acquired all available shares of Partnership Pacific Limited and Westpac Merchant Finance Limited.

The following year the NAB made two acquisitions from the Chase–Manhattan Overseas Banking Corporation with a 50% shareholding in Chase–NBA Group Ltd., and Chase–NBA Securities Ltd. ANZ acquired the minority shareholdings in Australian International Finance Corporation (AIFC) and Delfin–BNY, and then merged these organizations with Grindlays Australia Limited and established ANZ Capital Markets Corporation Limited, a merchant banking operation. Other acquisitions within the ANZ
banking group that year included the New Zealand organization UDC Endeavour Building Society; a 50% interest in Metropolitan Life Assurance Company; and the business operations of Barclays Bank PLC in Fiji and Vanuatu.

During 1985–1986 ANZ acquired Greater Pacific Life Assurance Company Limited; the remainder of the capital of ANZ Banking Group (New Zealand) Limited; and the ANZ Merchant Bank Limited was incorporated in the United Kingdom. The NAB acquired a 74% interest in a New Zealand finance house from the Government Life Insurance Corporation during the 1986–1987 financial year. In April 1987 Westpac increased to full ownership its 50% equity in Ord Minnett Group Limited, an Australian stockbroker; and acquired 100% of Wepco Holding Company Inc., a dealer in U.S. Government and Agency Securities, which later traded as Westpac Pollack Government Securities. By the end of 1987 ANZ had acquired the remaining 50% of McCaughan Dyson Co. Ltd., and established ANZ Capital Markets Corporation (N.Z.) Limited. Westpac contracted to purchase Shell House in Sydney during 1987–1988 which significantly extended their Sydney central business district private land holdings, and in May 1988 the bank expanded its interests in Information Services with a 19% purchase in an Australian computer service group, Computer Power Group Limited.

The Commonwealth banking group acquired full ownership of the merchant bank, Australian European Finance Corporation Limited (AEFC), during 1988–1989. On May 31, 1989 the bank acquired a 75% shareholding in a New Zealand retail bank, ASB Bank Limited. The major acquisition of the Commonwealth bank during the 1983–1991 period was the State Bank of Victoria on January 1, 1991, which increased the bank's service network to 1,794 branches and service centres. ANZ continued its acquisitions with the Post Office Bank Ltd. (POSTBANK) New Zealand and Mercantile Credits Limited becoming part of the group. The latter was acquired by Esanda (part of the ANZ Group)
in 1988–1989 and effectively increased the ANZ group's share of the Australian finance company market to 23%. Esanda also acquired Clark Equipment Credit Australia Limited during this time, a specialist capital equipment financier. ANZ McCaughan increased their coverage of the Sydney market with the acquisition of Morgan Grenfell Securities into the Group during January 1989, and National Mutual Life's banking arms — National Mutual Royal Bank in Australia and National Mutual Bank New Zealand Ltd., were acquired in 1989–1990.

In July 1990 the ANZ Banking Group acquired Town and Country Building Society, a West Australian based organization, and Olcc Trustee Limited in Jersey added to the Group's offshore acquisitions in November 1990.

4.4 Sales of Property.
The NAB sold properties (buildings) on a consistent basis over a number of years after deregulation, with some properties being leased back. The use of leased premises rather than freehold provides for the preservation of capital or the availability of funds, which may improve the bank's working capital, and may be a strategy employed in the normal course of business operations. The main point is that land and buildings are commonly treated as a fixed asset; they are not regarded as items to be traded in the normal course of business during a particular accounting period.

The following details of property sales during the 1980s are from the NAB's annual reports:

- 1983–1984 $ 65 million;
- 1984–1985 $ 26 million;
- 1985–1986 $ 19 million;
1986–1987 $24 million;

Details of sales of property during the remaining years to 1991 were not so readily disclosed in the annual reports, which means property sales may not have occurred after 1987, or the financial details of such sales were not as obviously provided. However, that the bank sold fixed assets from time to time suggests that sales of fixed assets were part of the bank's normal trading operations. Ownership of property is not essential to a firm's continuing business operations, although the use of the property may be. Classifying property as a fixed asset and then selling the property during the normal course of business, means that the property was incorrectly classified, and the bank as a business firm changed its structure and its business operations during an accounting period. This illustration emphasizes that firms sell properties from time to time to help finance their business operations.

Westpac, like other Australian financial institutions after deregulation of the Australian banking industry, sought to expand and ensure that its competitive position within the industry was not eroded by the increased competition of the new environment. The changing attitude and aims of the bank during the 1983–1991 period are emphasized by the following quotes:

'...the bank has reinforced the commitment to its driving force of servicing customers competitively.' (1983, p13)

'...a number of foreign banks will be commencing operations in Australia during the year, bringing substantially increased competition in a limited and mature market.' (1985, p6)

'Banking conditions in Australia were influenced greatly by a combination of very
high interest rates and intensifying competition.' (1986, p4)

'In the future, the Group will continue to develop new products, new ways of doing business, and new markets to provide increasingly valuable services on a world-wide basis to corporate and commercial customers, governments and investment institutions, as well as other financial institutions and individuals.' (1987, p3)

'Given the rapidly changing environment, domestic positioning also calls for constant attention to the way services are delivered and to related organizational and management structures.' (1988, p9)

By 1989–1990 the primary concern of the Westpac Group was to concentrate on core–banking business and that concentration included a strategy of selling properties and/or closing some business operations:

'...the sale, closure or integration of some peripheral businesses to permit management's attention to be focused on the Group's core businesses...' (1990, p2)

'...operations of Westpac Pollock Inc., a primary dealer in US Government and Agency Securities, have been wound up...' (1990, p2)

'...Westpac Life was sold to the AMP and, from 1 October 1991, changed its name to AMPAC Life Limited.' (1991, p12)

'...Westpac Travel was sold to Australian Airlines...' (1991, p9)

'...consider the sale of any operation where the sale proceeds exceed the value that
These quotes show that banks change business operations; their internal structure; operating procedures; and when deemed necessary for continuity of business obtain current market values for the various property items that contribute to their operations.

4.5 Non–Core Banking Business.

Non–core banking business includes all areas that are subsidiary to a bank's retail and wholesale operations of providing financial products and services through the branch network. For example, Westpac in their annual report (1987, p2) stated 'In addition to traditional banking, the Group's Retail and Wholesale banking activities include Investment Banking, Merchant Banking, Stockbroking, Development Finance, Investment Management, General and Life Insurance, Bullion Dealing, Trading in Government Securities and Travel.' This section illustrates a number of these subsidiary interests of banks such as travel, stockbroking, merchant banking, general and life insurance, and finance. It also examines changes that have occurred within these non–core areas during the period under review.

4.5.1 Travel.

The NAB had a network of 63 travel centres established by 1984, 69 outlets by 1988, and had rationalized the number to 65 by 1991. Locations of the travel centres were changed from time to time with the NAB closing low profit performers and opening other centres in different locations. During 1984–1985 the NAB wholesale travel subsidiary Prima Holidays expanded its business operations to Europe, Asia, America and China, and so changed the original structure of the firm, as well as altering its business operations to cater for a larger geographical area. Technological changes during 1988–1989 for NAB travel resulted in the
introduction of a new interfaced reservation system to improve competitiveness and customer service.

By 1986 the Commonwealth bank’s travel subsidiary, Travelstrength Limited, had been in operation for 10 years and by 1987 had established 37 nationwide travel locations to cater for the changing market trend from domestic to international travel. In August 1990 the ANZ Banking Group announced the sale of ANZ Travel, but details of travel services prior to the sale were not provided.

4.5.2 Stockbroking.

In September 1984 the NAB entered the stockbroking and investment business through its acquisition of A.C. Goode & Co. The following year it developed new services such as individual share market advice, portfolio planning, and corporate capital raisings. By 1986 the bank had expanded its computer facilities, introduced a portfolio management service, and an electronic video text telcbroking system. The NAB increased its shareholdings in A.C. Goode & Co. from 50% to 100% by the end of 1987, and during the following year merged the fixed interest division into group treasury so rationalizing some activities within the stockbroking arm. In April 1989 the NAB opened an office in Tokyo and by the end of 1989 the New York office was relocated to Boston. However, during the financial year 1989–1990 the NAB closed A.C. Goode & Co. its stockbroking subsidiary.

Westpac expanded its stockbroking interests during 1987–1988 through the business interests of Ord Minnett Group Limited which were extended to Tokyo and Hong Kong. Investment banking products and services were enhanced within the bank’s Asian Division during this time. The bank’s annual report (1988, p24) stated that eleven new issues were managed by Hong Kong operations, its stockbroking activities were expanded, and Mase Westpac’s global bullion network was used to elevate Westpac to ‘become a leader in gold
loan project financing.’

4.5.3 Merchant Banking.
The merchant banking operations of NAB were extended during 1984–1985 when First National Limited established a First National Resources Trust with an initial investment of a 10% share in Portland Aluminium Smelter, and expanded investment banking and leveraged leases during 1985–1986. In December 1985 the subsidiary finance operations were expanded when National Australia Fund Management commenced operations. Custom Credit also expanded its services during 1985 with customcard, a provision for revolving credit facilities to American Express cardholders, and provided specific businesses with private-label credit card facilities.

The Commonwealth bank expanded its merchant banking operations during 1988–1989 when it increased its 51% interest in AEFC by acquiring the remaining 49% from the Banque Nationale de Paris, Banca Nazionale Del Lavoro, and Dresdner Bank A.G. This resulted in the activities of AEFC being fully integrated with the banking group. The bank established institutional banking as a business unit during 1990–1991 which involved approximately one third of the Group assets.

In January 1986 the ANZ group integrated business operations in London, trading as ANZ Merchant Bank Limited, by combining the activities of Grindlays, Investment Bank and 100% owned London stockbroker Capel–Cure Myers. During 1986–1987 the merchant investment banking arm of the ANZ Group introduced a new range of investment trusts. An update of the automated documentary letter of credit system was established the following financial year, and a cash management service was extended to Western Australia and Tasmania through Executors and Trustees Services.
Partnership Pacific Limited, Westpac's wholly owned merchant bank, changed their operating structure within the investment banking group around 1987 by amalgamating treasury and capital market units. During this time they also relinquished the foreign exchange trading licence of Partnership Pacific Limited and linked the two units, Asset Based Finance and Project and Advisory Services to the Corporate Banking Division. During 1988–1989 Westpac changed its merchant banking operations due to financial losses and economic changes within the environment. Westpac's annual report (1989, p10) stated, ‘...lending functions of both merchant banks [are] now being absorbed into Westpac, and the companies themselves [are] focusing on fee generating activities rather than on commercial and corporate lending.’

4.5.4 General and Life Insurance.

In November 1985 National Australia Life Limited introduced a new product, Personal Loan Life Insurance Cover, and during 1986 introduced a mortgage repayment insurance product and a yearly renewable term life policy for bankcard customers and group staff. The Commonwealth Savings Bank's insurance scheme recorded a total insurance cover of $11,000 million in 1983–1984; by June 30, 1985 total insurance cover was $13,480 million; the following year it was in excess of $15,900 million; and by the end of 1988 was approximately $17,900 million.

An optional annual indexation of insurance cover was introduced to allow for inflation during 1986–1987 and the following financial year the bank expanded services to offer a contents insurance facility. Commonwealth Life Limited a new life insurance subsidiary was established during 1988–1989 and introduced its first product in September 1988, an Insurance Bond with 'Capital Secure' and 'Managed' segments. Executors and Trustees Services, a division of the ANZ Banking Group, extended life insurance operations to New Zealand during 1986–1987.
4.5.5 Finance.

The First National Limited expanded fee-based operations during 1986–1987, created a financial services division from the amalgamation of the Project Finance and Investment Banking Divisions, and also established a Mergers and Acquisition Division. National Australia life Limited in its second full year of operation 1986–1987 expanded its range of investment and superannuation products: for example, in January 1987 two annuity bonds in the area of superannuation and investments were introduced and National Australia Investment Bonds introduced $29 million in premiums from May to September 1987. Two new products ‘Masterttrust’ and ‘Income Protection’ were introduced that year along with a financial planning service – with recruitment of over 100 consultants. The financial planning service was expanded during 1988–1989.

National Australia Financial Management Ltd., originally named National Australia Life Limited introduced the following products — New Investment Trusts, Entry-Free Investment Bonds, Upgraded Income Protection Insurance, Friendly Society Bonds, and Immediate Annuities. A new corporate division was also established to provide superannuation, life insurance, funds management and executive financial planning.

The Commonwealth Bank Finance Company (CBFC Limited) increased its product range in 1987–1988 with the introduction of operating leases which covered capital equipment items from aircraft to fleets of motor vehicles. The following year motor vehicle fleet leasing in conjunction with Leaseway Transportation Pty. Ltd. was introduced. In late 1987 a Financial Services Division of the Commonwealth bank was established to complement Deposit and Investment Products, and included the bank’s Portfolio Management Services.

An amendment to the Commonwealth Bank Act during the financial year 1987–1988
enabled the expansion of investment products such as, Insurance Bonds and Unit trusts. During 1989–1990 the Financial Services Division catered for the introduction of a Personal Superannuation Product with no entry or exit fees and established a national sales network of 23 investment centres and 31 individual investment consultancies. The bank (1990, p20) stated that the Financial Services Division ‘...launched twelve products during 1989–1990...central to our long-run strategy plans [to] provide for aggressive but disciplined expansion.’ By 1990–1991 this Division of the bank provided 20 superannuation, investment and life insurance products; and the total funds managed had increased by 37% to over $10.6 billion.

The ANZ bank introduced a new superannuation scheme during 1985–1986 through Investment and Trust Services, which was aimed specifically at small business and commercial clients. At this time Esanda Limited introduced a new trade finance facility which served to increase funding for the development import opportunities. Daiwa ANZ International commenced operations in December 1985. This organization was established as a three way joint venture by the ANZ bank (50%), Daiwa Securities Co. Ltd., and Nippon Life Insurance Company. The venture was to provide clients with capital market and securities facilities, as well as access to Japanese stock markets for Australia, New Zealand and other Oceania countries. Esanda Finance Corporation introduced an integrated motor vehicle fleet management facility in conjunction with an Australian fleet management company in 1986–1987.

ANZ McCaughan developed a retail and international futures capacity with 24 hour futures trading during 1988–1989. Esanda introduced ANZ Maxi Safe, an ‘approved deposit fund’ which invested primarily in Esanda securities. In October 1989 ANZ Funds Management was established from the combined operations of ANZ Life, AFT, and Investment and Trust Services. This change was to service the growth in life assurance, superannuation,
and managed funds.

In October 1990 the bank established the Institutional Financial Services Division, primarily to develop and enhance relationships with large Australian and international corporations and governments. Services of the Division include relationship banking, capital markets, security services, and services provided by ANZ Capel Court and ANZ McCaughan Limited. During 1988–1989 Westpac in New Zealand introduced investment property loans, applied for a banking licence in France and stated in its annual report (1989, p1) that the entity ‘...announced plans to acquire 50 branches and approximately $900 million in assets of Banque Indosuez in New Caledonia and French Polynesia.’

4.6 International Operations.

International banking services were available through the Australian banks prior to deregulation, in the form of representative or branch offices of the relevant Australian bank in a number of overseas countries. The banks expanded their overseas operations from time to time, by opening new representative offices or obtaining a full branch licence. Deregulation brought opportunities that had previously not been available to the Australian banks, in addition to increased competition from foreign banks and the subsequent increased market pressure, the banks were now able to move off-shore in a more competitive manner. Australia proceeded to expand its international banking business and created new opportunities for increased business and global exposure.

4.6.1 National Australia Bank

In 1987 the NAB expanded international operations by acquiring the Clydesdale Bank PLC of Scotland and two Northern Irish banks which were subsequently renamed National Irish Bank Ltd. In 1990 Yorkshire Bank PLC – U.K. became a subsidiary of the NAB and the
following year the NAB acquired full ownership of their New Zealand banking operations. This complete ownership of foreign banks was a distinct change in banking operations and structure for the NAB. Previously the Group was represented internationally but retained a national identity. With deregulation, the Group became owners of banks indigenous to foreign countries, thereby becoming a multi-national organization.

During 1983–1984 the bank introduced a new International Services Department to develop activities in the capital markets area. The International Banking Divisions offshore lending portfolio was expanded with continuing emphasis on quality lending within developed countries. During the same period exchange control regulations were removed which allowed the banks to increase service for customers; for example, to provide Australian customers with the choice to retain funds in foreign currencies on or off shore. This allowed bank clients to minimize interest costs and exchange risk. The NAB also commenced operations in Athens with a representative office to support the bank's move into markets of South East Europe and the Middle East.

The following year representative offices were opened in Kuala Lumpur, Bangkok, San Francisco and Frankfurt. A wholly owned merchant bank was established in New Zealand, and agreements were signed with two provincial authorities in Peoples Republic of China—the Jiangxi and Tianjin International Trust and Investments Corporations. In June 1985 the bank signed co-operation agreements with the Agricultural Bank of China. In 1985–1986 the NAB Group had a global network of 18 overseas offices in 13 countries.

Expansion continued the following year with a representative office being opened in Taiwan. In late 1987 a new company was established to enhance trade related business, International Trade Management Pty. Ltd. During the 1987–1988 financial year the NAB Group opened a second representative office in Shanghai, China, and in New Zealand the
bank started international operations and commenced commercial banking. A new service was introduced by the International Banking Division during 1988–1989, a ‘Trade Package’ for export/import business. Expansion of overseas facilities, the introduction of new services and the search for new markets is evidence of the NAB’s flexible attitude to business operations.

4.6.2 Commonwealth Bank of Australia

The Commonwealth bank chose a circumspect approach to the challenges of the new financial trading era and stated in its annual report (1984, p12) that ‘The international environment in which the commercial banks operated during 1983–1984 was ... marked by caution and conservatism.’ The bank attempted to assist exporters by providing financing proposals, but acted carefully because of the large debt carried by some overseas countries and the adverse affect this may have on Australian export earnings if a debt burdened country was unable to pay.

Examples of regulation changes that affected the bank’s international operations during this time include: the floating of the Australian dollar in December 1983 and the granting of foreign exchange dealing licences to 40 financial institutions. A new environment for Australian foreign exchange dealers was thereby established.

Reciprocal arrangements between Australia and overseas countries have occurred and the increased competition meant that banks moved swiftly to penetrate new markets and seek opportunities that were previously denied them. In May 1985 the Commonwealth bank opened a representative office in Frankfurt, and in August 1985 a fully licensed branch was opened in Chicago. The following financial year branches were opened in Tokyo and Hong Kong, and the bank appointed a Middle East Area Manager for the People’s Republic of China. During 1986–1987 the Commonwealth bank organized new financing packages for
Australian exporters to assist them with trading opportunities.

In November 1986 the bank opened a business migration centre in Hong Kong. This centre was to provide an information service for potential emigrants to Australia in relation to opening a business, pursuing a professional career, or seeking other employment. To support the development of the Asian market the bank introduced its own $500 million facility, Telecom's $200 million facility, and others. The bank also assisted the development of an investor base and liquid secondary market in Hong Kong during 1987.

By 1987–1988 the Commonwealth bank had expanded to Asia, Europe and North America. In addition to this the bank ensured correspondent relationships existed (1988, p10) '...with over 1,100 banks located in nearly every country of the world.' The bank responded to the increasing financial activity between Australia and Korea by improving their specialist ability in that area, with the appointment of an experienced Korean banker during late 1987 as Area Manager of Korea, based in Sydney. This position was to provide specialist advice as a support to existing and potential trade operations, as well as providing an investment and financial link between countries.

By 1990–1991 the bank had closed the Chicago branch and rationalized the branches in New York, Los Angeles, and London. Since deregulation the Commonwealth bank has continually altered its organizational structure and business operations to retain a competitive position within the new international banking environment. These changes have been by expansion of products and services, expansion of international network, rationalization of business operations, and initiating internal changes to improve relationships between the bank and its customers.

4.6.3 ANZ Banking Group
The ANZ bank is well represented internationally with representative offices and branches in most overseas countries. During the 1983–1984 financial year the ANZ bank established representative offices in Toronto, Zurich, and Frankfurt. During the following year the bank opened a representative office in Bangkok and in 1985–1986 the bank had expanded its international business activities to Continental Europe, United Kingdom, South–East Asia and New Zealand. In February 1986 the bank opened a branch in Frankfurt which replaced a representative office, and opened a representative office in Milan as well as a finance company. To maximize the trading potential of its international network the bank established a specialized Trade Financing Division in the United Kingdom, and also established ANZ Finance Limited. In addition the ANZ bank opened a representative office in Beijing and established a branch in Hong Kong which replaced a representative office.

In New Zealand the bank altered its organizational structure as its annual report (1986, p16) stated, ‘...the aim is to eliminate bureaucracy and make the organisation more customer responsive.’ During the year lending rates were reduced (1986, p16) ‘In response to lower cost of deposits and to maintain a competitive position in the market...’ ANZ Capital Markets corporation (ANZCAP) expanded at this time and opened a branch in Auckland. Retail banking in New Zealand introduced a new cheque book based product in 1986–1987 the ANZ Call Account.

An offshore holding company, ANZ International Limited, was established by the bank in Singapore during 1986–1987. The bank continued to renovate and upgrade branches in India including the computerization of systems and by the end of 1988 the bank had achieved the automation of over 80% of customer accounts in that country. A new branch was opened in the Pacific Islands at Sigatoka, Fiji. The following financial year the ANZ bank opened a new branch in Paris, Grindlays Bank SA. Other expansions during
1987–1988 included the establishment of a merchant banking presence in Zimbabwe and a new office in Hong Kong.

During 1988–1989 the name Grindlays Bank PLC was changed to ANZ Grindlays Bank PLC, and the annual report stated the reason (1989, p19) that 'The objective is to project a global marketing image, whilst still retaining the value and reputation of the Grindlays' name.'

During the 1990–1991 period the ANZ bank opened an office in Santiago, Chile and two new branches were opened in Zimbabwe. Automation overseas was continued with the installation of Automatic Teller Machines in India, Bangladesh and Sri Lanka. The bank opened a representative office in the Philippines and a branch in Osaka, Japan. Card based services were expanded in New Zealand at this time with the introduction of the VISA card.

The ANZ Bank (1990, p10) stated 'We believe that international competitiveness is essential in today's globalised financial services industry. Our central principle is that international success can only spring from strength in home markets. Thus, we have been in recent years acquiring businesses which strengthen our core financial services position in Australia, New Zealand, and the Pacific and disposing of activities which were not consistent with that objective...Businesses not consistent with our strategic direction were downsized or disposed of during the year.'

4.6.4 Westpac Banking Corporation

Westpac's banking relationships extend throughout Asia, Europe and North America. Deregulation and the subsequent entry of foreign banks to Australia meant that Westpac
and other Australian banks were able to establish banks in Asia due to the removal of reciprocity barriers between the continents. During 1984–1985 Westpac opened a branch in Tokyo and a representative office in Kuala Lumpur, and the bank also applied for a branch licence in Taipei. To highlight the bank's international involvement, Westpac's annual report (1985, p15) stated 'The International Financial Institutions Division conducts over 1,600 correspondent relationships in more than 100 countries with overseas banks and major financial institutions.'

During 1985 the Americas Division of Westpac developed ficc based services (1985, p17) '...for corporate commercial paper programs and tax—exempt bond issues by United States Municipalities and other Quasi-Government entities.' In May 1986 the bank opened a branch in Seoul, whilst Australian Guarantee Corporation Limited, which was 76.8% owned by Westpac, established AGC Finance (SI) Limited a new company, in the Solomon Islands, and opened a second office in Hong Kong. The following financial year Westpac opened a representative office in Columbus, Ohio.

The bank elucidated its business operations in the annual report (1987, p2) which stated 'The primary financial objective of Westpac Banking Corporation is to achieve long term growth in earnings per share. Underpinning this objective is the Group's strategy of increasing product diversification while maintaining leadership in home markets and pursuing leadership in selected global markets.' At that time the bank operated in 23 countries and had widely diversified business interests. Three years later in June 1990 the bank opened a representative office in Paris, whilst during the 1990–1991 period rationalized business operations throughout Europe, for example closing the representative office in Frankfurt, selling the UK Residential Mortgage portfolio and an investment interest in Portugal.
4.7 Conclusion.

This chapter provides illustrations that emphasize the adaptability of the business operations of the Australian trading banks since deregulation of the Australian finance industry. Throughout the period 1983–1991 the banks continually adjusted their organizational structure and operations to continue operating as viable businesses. Deregulation of the Australian banking industry resulted in a new environment for financial institutions in Australia with customers placing increased demands on the banks in a volatile market.

Examples are presented of the ways in which the four major Australian banks adapted their operations in this dynamic environment — including their attitude to product development, nature and scope of services provided, geographical trading locations, subsidiary interests to core banking, and structural change by way of acquisitions and internal reorganization. The reason for choosing banks is because they are generally considered to be 'conservative' organizations. If such firms are adaptive enterprises, it may be that firms generally behave in a similar way.

While no general conclusions may be drawn from this study about the nature of 'going concerns', the study does support the notion that the financial capacity of firms to survive in business is dependent upon their continually adapting their operations in accordance with changed and changing market conditions.
CHAPTER FIVE

FACTS NOT CONJECTURES DETERMINE A GOING CONCERN.

'It is difficult to justify the assumption of a going concern because of uncertainty about what the future holds, particularly in matters of commerce.'

Sterling (1968, p501)

The conventional accounting wisdom is that business firms, as 'going concerns', are static entities that operate the same style of business indefinitely. This idea has become an integral part of accounting wisdom and practice during the twentieth century — despite much criticism. It is the rationalization for accounting procedures such as arbitrary cost allocations across a number of accounting periods, the deferral of costs, depreciation of durables on the basis of cost, and the matching of costs and revenues in the calculation of a periodic profit.

Contrary to the conventional accounting wisdom is the idea that firms are dynamic entities that continually adapt their business operations in the light of changing market and economic conditions. By recourse to the literature of economics and deliberate action, this thesis argues on analytical ground that firms are adaptive entities. By reference to the business operations and organizational restructuring of the four major Australian trading banks during the period 1983–1991, evidence is presented that supports the idea that banks — at least — conduct their affairs in an adaptive manner. The banks could not be properly described as 'going concerns' in the conventional accounting sense.
Being predicated on the assumption of firms being 'going concerns' in the 'static' sense, the relevance, reliability and usefulness of conventionally—prepared financial statements is questioned. It is argued that the conventional accounting idea of 'going concern' is flawed. Consequently, financial statements based on cost allocations and cost deferrals are unserviceable. If the accounting profession is to produce factual, independently verifiable reports it must change the foundation upon which accounting procedures are developed.

5.1 The Fixed State of a 'Going Concern'.

The assumption that a firm will continue operating and in the same manner has obtained at least since Dicksee (1892). A basic objective of financial statements is to provide users with relevant, reliable financial details to assist them in decision—making. This consideration may be extended to both internal and external users of accounting reports.

A fundamental accounting problem is that of identifying and reporting periodic business transactions. The tendency to focus on transactions and to disregard other events (price changes and changes in the value of money) fosters indifference to up—to—date factual information. It is argued under the conventional 'going concern' notion, that the cost associated with a purchase made in one period may legitimately be spread over future accounting periods because of perceived benefits that are likely to accrue to the firm. Conventional accounting treatment of a firm's major assets like stock—on—hand and durables invokes this idea. 'Unless care is taken to include in the economic entries of a period all that properly belongs in it and to exclude all that pertains to any other period before or after, we may greatly distort the presentation of facts...' Sprague (1907, p69)

The future is not known and any relation between a present cost and a future benefit is pure speculation.
There is no connection between estimated dated residuals as detailed in conventionally prepared financial statements and management's business performance for a specific period. The operating result presented is a calculation based on a mixture of estimates, speculations, conjectures and personal judgements, which accounting standards in all western countries allow (and sometimes insist on). These details provide non-factual financial information to users of financial statements that discredits the idea of information usefulness to assist in decision-making.

Managers, investors, creditors, government bodies and other interested parties might expect to receive reports that contain financial details specific to the date of the issued statement. Conventional financial statements do not provide such current details and so if required, interested parties must attempt to discover these dated monetary facts by some other means.

5.2 An Adaptive Entity: A Going Concern.

A contrasting view to the conventional idea of the firm as a 'going concern' is that of one which continually reacts to characteristics of the economic environment. Firms operating within the market are dynamic entities that respond to environmental changes and at times initiate different trading strategies to increase market share or growth potential.

The illustrations in chapter four present business entities as flexible and adaptable, but complex organizations. Four major Australian banks were chosen as the subject for this study and their annual reports provided the main source of data. Banks are generally viewed as 'conservative' entities and selecting such firms (rather than firms operating in a more volatile environment like the mining industry) reduced the risk that subsequently documented examples of change would be biased away from the conventional 'going
concern' idea. In other words if firms often perceived as conservative were shown to be dynamic trading entities it would strengthen the suggestion that firms in changeable industries – in fact, all firms – would be adaptive organizations.

The period covering deregulation of the Australian financial industry was considered appropriate because it provided a changing economic environment. The argument is if banks as trading firms were seen to alter business operations to respond to their current environmental needs the entities should properly be considered as adaptive, not static firms. Illustrations and examples of the bank's business operations during this period (1983–1991) have shown that the firms conducted business operations in a dynamic and highly competitive manner.

5.3 Conclusion

A firm operating within the market must first and foremost be solvent to survive and continue trading. The nature and structure of economies and markets change. Economic conditions cause changes in the industrial and market environments in which consumer preferences subsequently alter, as do competitive tactics between firms within and across industries. This results in the introduction of new products and services or an upgrading of existing products and services often made possible because of technological advances. New firms emerge within growth industries where the market has identified a potential for profit making, while old firms leave other industries due to increased competition or other trade related circumstances which decrease a firm's financial capacity to survive.

The untested assumption of a firm's buoyant financial status does not provide a legitimate basis upon which to compile financial information. Knowledge that a firm is solvent, has the capacity to pay its debts when due, or to continue business operations to meet the
demands of a changing economic environment is an essential element in financial administration. The function of accounting is to provide factual and up-to-date information about those financial features of firms.

Such information would constitute current, reliable and relevant financial details to all users to assist their decision-making. Analysis of the financial consequences of a firms' periodic business transactions would be imbued with meaning as analysts would have factual, and up-to-date monetary amounts to use in their determination of such standard measures as the firms’ dated net tangible asset backing, earnings per share, debt to equity, rate of return and other financial indicators used to analyse structure and operating performance. Finally, financial facts rather than ‘phantasmagoria’ would provide the fundamental basis for financial statement preparation.

Financial position is the dated set of money—quantified relationships between an entity and the rest of the world arising from property and contractual rights and the state of the entity’s selling markets at the stipulated date. It relates to the financial capacity of an entity to buy and sell – to engage in trade – at a given time.

Wolnizer (1990, p6.)
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