THE FINANCIAL STATEMENT DATA OF FAILED COMPANIES:
THE ROLE OF THE AUSTRALIAN ACCOUNTING PROFESSION

by

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Thesis submitted for the Degree of Doctor of Philosophy,
Department of Commerce, University of Adelaide,
December 1986
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SUMMARY

This thesis tests two related hypotheses referred to as the misinformation hypothesis and the responsibility hypothesis. The misinformation hypothesis postulates that

certain failed or failing companies produced financial statement data which misrepresented their results and financial position, and therefore, did not provide investors with a clear warning of their demise.

The responsibility hypothesis postulates that

the accounting profession can be held responsible, at least in part, for any misrepresentations in these data.

The hypotheses are tested using six case study companies which failed in Australia between the early 1960s and the late 1970s. First, the losses of investors in the company are calculated to show that the failure is significant from the investors' viewpoint. Next, the misinformation hypothesis is tested in two separate steps. The condition of the company prior to failure, as depicted by its financial statement data, is assessed. Then, any misinformation embodied in the financial statement data is identified. Finally, where misinformation exists, the responsibility hypothesis is tested by determining whether the misinformation resulted from compliance with, violation of, or ignorance of generally accepted accounting principles. The case studies are selected from two decades in an attempt to isolate any effects of improvements in the specification and enforcement of accounting principles since the early 1960s.

The evidence from the case studies is consistent with the misinformation hypothesis. Each of the case study companies, or companies closely associated with them, have produced some financial misinformation. However, the evidence is not consistent with the responsibility hypothesis. In four of the six case studies, the misinformation resulted largely from the violation of accepted accounting principles and, therefore, was primarily the responsibility of the
management and the individuals involved in the preparation and audit of the case study financial statement data. In the remaining two case studies, the misinformation related to the valuation of development real estate and was probably the responsibility of qualified valuers rather than accountants. Whilst the accounting profession cannot be held responsible for misinformation contained in the financial statements of the case study companies, the profession can be criticized for its apparent failure to discipline members for non-compliance with accepted accounting principles and for its failure to develop clearly defined principles in the troublesome area of accounting for development real estate,