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ACCOUNTING: Legends, Myths and Realities

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The views and opinions reflected in this presentation
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“Order and clarity stimulate the desire to save and obtain riches. For a man with poor self-administration, the best situation is the cloudy one. For an orderly man there is nothing more enjoyable to make count of their growing profits every day.

When I review our books and see the ease to which they show the status of our heritage, I am always amazed by the great advantages that the **doubly entry** provides to the merchant. **It is one of the most beautiful discoveries of the human spirit** and all those who aspire to manage well should take it.“

Johan Wolfgang von Goethe (1749-1832)

“The double entry was born from the same spirit than the systems of Galileo and Newton [...] to order the phenomena in an artistic system [...] the double entry discovers the world economy for us, and more specifically the capitalist one”

Werner Sombart (1863-1941)

Language, Law, Money and... Accounting

Accounting ≠ Book-keeping

Book-keeping

- Is the process of accounting data
- Basically conducted through computers

Accounting

- Measures the economic resources that a specific entity has
- Reflects obligations against that particular entity
- Measures the changes in the economic resources and in the obligations of the entity
- Assigns changes to a particular period of time
- All the previous expressed in common monetary terms

“The accounts are, in fact, no more than an “ad hoc” ordering thought by the merchant with the purpose that its regular usage provides him with constant information of all his businesses, so that he can easily know if things are going well or bad“

Luca Pacioli (1447-1512)

Accounting: Legends, Myths, ...

“Accounting is a science”

“The benefit of the year is the money that the entity gained that year”

“Dividends are the part of the benefits that is given to the shareholders”

“Provisions for doubtful and bad loans are funds that the entities created to deal with future problems of current customers”

“A provision for a credit or a loan portfolio is
a realized loss”

“Equity is the money that comes from the owners’ contributions (eg: shareholders) plus the benefits from previous years not distributed by the entity”

“Capital or equity is the amount that protects creditors from losses and unexpected risks”

“Individual Financial Statements are of little relevance to investors and supervisors. Consolidated statements better reflect the "real" situation of banks' balance sheets and their results”

“Goodwill is the sum of the brand value plus other intangibles”

“Fair value should be blamed for the financial crisis. Historical cost better reflects the “real” situation of an entity”

“Situations where the market value is lower than the value in the balance sheet (book value), are aberrations of the market”

“The economic consequences of a particular accounting rule for a sector of the economy is reason enough for not applying it”

Accounting Realities

“Accounting is a human invention”

With the exception of cash, all the amounts shown in financial statements are the result of an estimate about the future, which is inexorably uncertain

Financial estimates are dominated by the "Efficient Market Theory" (EMT) and the orthodoxy of the rationality of the operators

But...

EMT does not consider the essential difference between "information" and its "proper interpretation"

Accounting data (and virtually all economic and financial data) are not discovered, are manufactured, so their apparent accuracy and precision can lead to the most unwary errors

Those who produce accounting data may deliberate attempt to distort the information they get

Trust and Reliability of accounting data should consider the influence of Human Nature

Those who work in the Sciences of the Nature (physicists, biologists, etc), do not face anything similar in their work

“God is clever and sophisticated, but not malicious”

(Albert Einstein)

Accounting are conventions in an strict sense, ie: criteria that are socially adopted to leave nobody benefited or harmed

- ENRON
- WORDCOM
- Royal Bank of Scotland (RBS)
- And...
 - Carillion
 - Toshiba
 - Steinhoff
 - Satyam Computer,
 - PrivatBank (Ukrania)
 - VBS Mutual Bank
- Andin the 20's
 - Kreuger & Toll
 - Insull Utility Investment

The double-entry book-keeping is an ingenious registration and accounting system, invented during the Middle Ages

Since then, it has been improved, and is and will continue being the only viable system for registration, evaluation and systematic summary of the countless and complex operations and activities of the business world

The only realistic hope is not their replacement but its completion, together with its continuous testing, particularly during crises

Thank You