

### ***Boom and bust economies – Inevitability of corporate collapse***

In the May 2003 edition of this column we discussed the inevitability of corporate collapse and in the June 2003 edition we discussed the issue of how well accounting deals with the declining asset values of collapsing companies. The major risk faced by auditors is giving an inappropriate opinion for a collapsing company. One factor causing problems in identifying poorly run companies that eventually collapse is the boom phase in boom and bust economies. These companies have access to cash during a booming economic period, allowing them to pay creditors. When the economy busts, the access to cash is stopped causing creditors to question the ongoing viability of the company. These companies may have also used questionable accounting practices during the boom period.

With the above in mind a speech given by Reserve Bank governor Ian McFarlane to the Business Council dinner on the 9 July 2003 discussing boom and bust economies should be of interest to auditors. McFarlane notes that recently Australia's economy is stable due to the absence of boom and bust cycles previously associated with the Australian economy. United States and Japan have suffered boom and bust economies causing their current economic problems. McFarlane attributes good economic policies and luck to the absence of the problems of boom and bust cycles in Australia's present economic condition.

However, McFarlane issues a warning to those who may think the absence of boom and bust cycles will be permanent in Australia. He states:

I would like to think that it was excellent economic policy that prevented us from participating in the binge, but that would be claiming too much. No-one really understands the relationship between macroeconomic policy and asset price booms and busts well enough to make that claim. The unfortunate fact is that it seems to be possible to experience an asset price boom in an economy where macroeconomic policy settings seem to be relatively well-disciplined and inflation quite restrained (p.4).

The presence of future boom and bust economies in Australia would strengthen the argument that corporate collapse is inevitable. Auditors should realise that history shows busts do follow booms and their conduct during booms should be such that it passes scrutiny that inevitably occurs if the company fails in bust cycles.

#### Reference

McFarlane Ian, *Notes for talk to Business Council of Australia Annual dinner – 8 July 2003*, [www.rba.gov.au](http://www.rba.gov.au)