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A CRITICAL EVALUATION OF FINANCIAL ACCOUNTING

IN

THE CARIBBEAN

by

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## INTRODUCTION

It is significant that in the development of social accounting, relatively little attention has been paid to the financial sector, with the result that we have fairly well-developed national income accounts, while little progress has been made towards the development of adequate theories and methods of financial accounting in the different types of economies. Since the 1930's national income accounting has undergone a substantial amount of development arising out of the work of KEYNES, but no comparable developments have as yet been recorded in the field of financial accounting.

Within the Caribbean the objectives of financial accounting appear to be unclear. The failure to define goals clearly, has been partly responsible for the haphazard manner with which financial statistics are collected. In the developed economy, where public policy is primarily directed at maintaining a dynamic stability, one of the major purposes of financial accounting is the desire to make available to the policy-makers data on the operation of the financial sector, which is necessary for informing a policy aimed at maintaining stability in the economy. On the other hand, in the Caribbean, assuming that the primary goal of the authorities is the achievement of the structural transformation of the economy, the primary objective of financial accounting should be the desire to make available to the authorities critical categories of financial statistics, which are essential for informing a policy geared towards ensuring that the financial sector is organised in a way which enables it to make its maximum contribution to the development of the economy.

The key to the need for financial accounting is to be found in the fact that no other type of accounts provide adequate information on money, and the various types of financial assets, which are critical factors in determining the level and types of economic activity within a monetised economy. As Patrick points out,<sup>1</sup> the provision of a wide range of financial assets, not only accommodates, but can induce growth, by generating incentives to savers to increase their rate of saving, to entrepreneurs to invest more, and to producers to work harder.

The new sense of urgency in developing adequate theories and methods of national income accounting in the 1930's is very marked. It arose out of the experience of the "great depression". This experience impressed upon the authorities the necessity for keeping at their disposal an up-to-date set of statistics on the performance of the economy. They sensed this urgency primarily in connection with the requirements of short-term economic policies. In the Caribbean the over-riding consideration in the collection of financial statistics should be for the purpose of informing long-term economic policies, specifically policies directed towards the<sup>2</sup> "structural transformation" of the economy. This does not entirely rule out considerations for short-term policy since, at the same time, there will be the necessity to maintain some kind of balance in the economy. Indeed, a long-term plan can best be implemented through a series of short-term plans, and it is in this light that short-term planning in the Caribbean should be viewed. The paper now proceeds

<sup>1</sup> Economic Development and Cultural Change. Vol. XIV., No. Jan. 1966. Financial Development and Economic Growth in Underdeveloped Countries. H.T. Patrick.

<sup>2</sup> Economic Development in Small Countries with Specific Reference to the Caribbean. W.G. Demas.

to attempt a critical analysis of the current state of financial accounting within the region, and discuss some of the operational problems encountered in the business of financial accounting in the Caribbean.

At the outset it is essential to recognize that the deficiencies existing in our methods of financial accounting within the Caribbean, are the results of a number of forces which have operated to shape developments in this field. Specifically, we need to address our minds to an analysis of the impact of a predominantly foreign-controlled financial system on the evolution of accounting procedures. Other important factors to which attention should be directed, are the force of tradition, the failure to appreciate the role of the financial sector in promoting the economic development of the region, and inertia. All these factors have co-operated to produce the haphazard approach to financial accounting within the region.

The failure to develop a financial system with an indigenous base, has been largely responsible for the problems encountered in data collection, excessive aggregation, and the existence of critical gaps in our knowledge on the operation of the financial sector. Because of the foreign-domination of the financial system, and until recently its great degree of independence from control by authorities in the region, local initiative paving the way for the development of effective accounting procedures, were either stifled or never raise its head. Possibilities for monetary management within the region are narrowly limited, and this tends to complicate the task of selecting and ensuring that critical categories of data are collected. The development of a comprehensive

set of financial statistics within the region, reflecting a proper balance between macro and micro emphases, critically depended on the extent to which the predominantly foreign-controlled financial system co-operated with the authorities.

Failure to appreciate the role of the financial sector in the development of the economy seems to be one of the major factors explaining the undeveloped state of financial accounting within the Caribbean. Because traditionally governments were accustomed to looking overseas for capital to finance various projects, no serious attempts were made to survey the potential of the region to finance its investments from its own sources of savings. The open nature of the economy has therefore operated in such a way as to delay the pressures making for a complete survey of the sources and uses of capital within the region, and by the same stroke has retarded the development of effective methods of financial accounting.

A well developed method of financial accounting can reveal much valuable information on the operation of the financial sector. For example, analysis of the liabilities of financial institutions, can reveal how the non-financial sector holds its savings. Analysis of the asset portfolio of financial institutions indicate the types of investments prepared by financial institutions, as well as the market potential for various types of securities. It is also possible that a study of the sources and uses of capital within the various sectors, and the possibilities for monetary management, can be substantially facilitated through the employment of the appropriate accounting procedures. These are only to stress a few of the important uses of an adequately-developed framework

for financial accounting. There are various techniques which can be employed to enhance the presentation of data, thereby facilitating the task of financial analysis. It is against this kind of background that an evaluation of the current state of financial accounting within the region will be attempted.

For purposes of analysis a useful distinction can be made between financial statistics published by the central-banking territories on the one hand, and the E.C.C.A. member territories on the other. This analytical distinction can be defended on several grounds, but most important, is the fact that the publication of financial statistics within the central-banking territories is far more organised and comprehensive than any of the publications by the E.C.C.A. member countries. This division does not overlook the fact that there are many deficiencies which are common to both groups, but the essential point which the distinction recognizes, is that in the field of financial accounting the E.C.C.A. member territories possess more in common among themselves than with the whole group with which the analysis is concerned.

#### DEFICIENCIES IN PRESENTATION

Financial accounting transcends the mere compilation and publication of statistical information. There are certain techniques which a properly-developed framework for financial accounting should reflect. To mention a few, (1) the organization of data should show a logical sequence; (2) certain crucial categories of data should be given prominence; (3) "totals" should be well-spaced so as to facilitate comprehension of the data; (4) some clear-cut distinction should be made between total

and sub-totals; (5) sources of data should be stated whenever necessary, and lengthy footnotes avoided.

#### Absence of Variety

There is little scope for specific comment on deficiencies in the presentation of financial statistics by the E.C.C.A. member territories, consequently the case-studies have been confined to the central-banking territories. Certain common deficiencies are to be noticed in the financial data published by the central-banking territories of the region. The marked absence of variety in the presentation of data hardly escapes the casual reader. Little use is made of graphical techniques. Some qualification to this comment is necessary in the case of Jamaica, where it is evident that a serious effort is made to introduce a reasonable amount of variety into its presentation of financial statistics. Variety in presentation of data enhances the readability of the statistics, by removing much of the monotony resulting from the stereotyped presentation of statistics.

#### Arrangement of Data

The comprehension of financial data could be substantially facilitated if the arrangement of the statistics always followed a logical sequence of development. For example, in the analysis of the asset portfolio of an institution, we might decide to arrange the items in decreasing order of liquidity. If "totals" were always well-spaced this could avoid much of the confusion resulting from the crowding together of three or four "totals", as is the case of the<sup>3</sup> Bank of Guyana's

<sup>3</sup> See: Bank of Guyana Annual Report. 1966. Table (2),9.

Analysis of Commercial Banks Deposits (Excluding Deposits from banks).

The failure to state sources of data is one of the most common problems to be noticed. Again some recognition should be taken of the progress made<sup>4</sup> by Jamaica and Trinidad and Tobago in this direction. Various problems can arise out of the absence of knowledge on the sources from which the statistics were compiled. For example, if the necessity to check the accuracy of data arises, knowledge of sources facilitates the task. A case in point, is the Bank of Guyana's<sup>5</sup> analysis of "commercial banks' deposits excluding deposits from commercial banks". Here the working of the data is unclear, and a knowledge of sources is most desirable.

Lengthy footnotes can detract from the presentation of financial statistics. Additional information on the statistics presented can more conveniently be provided in a separate section possibly labelled, "Notes to Tables". Such a practice is followed in Jamaica, but there is much scope for enhancement of presentations by the pursuit of such a practice, not only among the other territories, but within Jamaica as well.

As far as possible meaningless distinctions should be eliminated from the presentation of financial statistics. The<sup>6</sup> Bank of Jamaica makes a distinction between the currency division and the banking division in the analysis of its assets and liabilities. There is no meaningful sense in which this distinction can be made in the operations of the Bank

<sup>4</sup> Bank of Jamaica Bulletin. March 1968. "Notes to Statistical Tables".

<sup>5</sup> Bank of Guyana Annual Report. Table (2),9.

<sup>6</sup> Bank of Jamaica Bulletin. March 1968. Table (1).



of Jamaica. The carry-over of this practice by the Jamaican authorities may be linked up with the influence which the practices of the Bank of England have exerted on the development of financial accounting within the region. In the case of the Bank of England this distinction today is an anachronism. It was first employed by the Bank of England when it functioned as a commercial bank and central bank at the same time. This distinction was not only meaningful when the Bank of England filled the dual role of commercial and central bank simultaneously, but it operated to maintain confidence in the management of the institution, by suggesting to the public that a failure in one aspect of the Banks' operation did not automatically affect the other. It is therefore evident that there is no rationale for the retention of this distinction by the Bank of Jamaica.

#### Excessive Aggregation

Because of the global type data which predominates publications of financial statistics within the area, it is difficult to acquire a clear picture of the intimate workings of the financial system. Many critical categories of data are unavailable for independent analysis. For example, the Bank of Jamaica<sup>7</sup> "Analysis of Bank Advances", could have served a wider range of users if it was less aggregative. Specifically, Agriculture could have been further subdivided into (a) Sugar-Cane Cultivation; (b) Livestock and Dairying; (c) Tree Crops; (d) Other Agriculture. If greater emphasis is placed on providing a more detailed breakdown of data, than practised at present, the statistics will provide

<sup>7</sup>

Bank of Jamaica Bulletin. March 1968. Table (9).

a clearer picture of trends in the economy as a whole, and within the various sectors. This will facilitate the task of detecting those areas of the economy which are under-served by the existing financial institutions, as well as provide the authorities with valuable information essential to the formulation of policies designed to encourage the establishment of credit institutions to service specific needs. Data which is too aggregative imposes severe limitations upon analysis, since the analysis has to be conducted at a macro level. The implication for financial accounting, is the necessity to strike a proper balance between micro and macro presentations of financial statistics.

#### Conceptual Issues

Problems in conceptualisation arise out of the attempt to categorise a particular type of data. Concepts employed should give a clear notion of the type of data to which they are supposed to apply. At the same time one should be careful in employing concepts in a way which restricts their use to too narrow a scope. The Bank of Guyana's analysis of<sup>8</sup> "the Liquid Assets of Commercial Banks and Determining Factors" provides a vivid example of this problem.

The concept of "fiscal balance" employed by the Guyanese authorities does not provide a clear notion of the class of data it is supposed to describe. A more explicit term, could be "Change in Government's indebtedness to the Central Bank and Commercial Banks", or change in holding of Government liquid assets by the banking system".

<sup>8</sup> Bank of Guyana Annual Report 1966.

The concept of the "balance of payments" used in the sense in which the Bank of Guyana employs it in their analysis of the "Liquid Assets of Commercial Banks and Determining Factors", is restricted to too narrow an interpretation. "Movements in the External Monetary Position of the Central Banks and Commercial Banks" more adequately describes the idea involved, and the concept of balance of payments should be released for use in a much wider content.

On the whole the Bank of Guyana's analysis of the Liquid Assets of the Commercial Banks and Determining Factors, is an intriguing case-study. It is impossible to compartmentalize the "determining factors" of the liquid asset of the commercial banks in the way it has been attempted in the Bank of Guyana analysis. The liquid assets of the commercial banks are determined by a complex of factors which are not susceptible to the type of accounting format employed by the Bank of Guyana. For example, the "foreign balances" of the commercial banks are as much determined by the demand for credit, and such other factors as U.K. interest rate yields and the level of imports.

Duplication of data should always be avoided since this not only wastes effort, but raises the question of reliability of the statistics presented. Again the Bank of Guyana's presentation of the "Analysis of the Liquid Assets of Commercial Banks and Determining Factors" provides vivid examples of duplication. "Changes in commercial banks holdings of Government securities" is partially duplicated in items (10) Local Treasury Bills; and (11) Other Eligible Credit Instruments. "Net acquisitions by commercial banks of liquid assets in the form of eligible Government or commercial paper"; item (2) also duplicates items (10)

and (ii). Every attempt should be made to avoid the usage of formats which lead to these kind of complications.

Certain adjustments to our balance-of-payments definitions should provide a clearer picture of the actual volume of private capital movements. It is reasonable to assume that in the case of the subsidiaries of international firms operating within the region much of the "private capital inflow" recorded in the balance-of-payments accounts is comprised of the reinvested earnings of the corporations. If the actual volume of private capital inflows and outflows were explicitly included in the accounts to replace "net movements of private capital", we should be able to ascertain a clearer picture of the extent to which the economy is generating its own sources of capital. Although the change in the arrangement of numbers does not alter the actual circumstances, the difference in interpretation may be substantially altered.

#### Non-Currency of Statistics

The problem arising out of the late publication of financial statistics varies significantly between the E.C.C.A. member territories, and the central banking territories. In the case of the E.C.C.A. member territories the problem is of a far more serious nature, since there is reason to suspect that financial statistics are often unpublished. Within the central banking territories late publications are often due to the increasing demands being placed on Statistics Division, and the failure to attract and retain the type of research intelligence needed for the task. Delay in compiling financial statistics reduces their usefulness in tracing short term trends within the economy, but late

statistics are better than no statistics at all, since they are still invaluable to the formulation of long-term economic policies. To dispose of the problem of "lateness", the authorities could decide to emphasize the selection of certain categories of data which are to be published promptly and regularly.

#### Critical Gaps In Statistics

Prior to an appraisal of the organisation of the financial sector, it is essential to be aware of the entire operation of all aspects of the financial system. An over-all assessment is necessary (1) to ascertain the volume of domestic savings being mobilized; (2) for purposes of planning; (3) for assessing how the structure of individual institutions affect their capacity to service the needs of the economy. There are substantial areas of the financial sector about which knowledge is either hazy or lacking. For example, trade credit and "Sterling area" transactions. To date, Jamaica is the only territory in the region which collects information on "Sterling area" transactions. Any effort to develop an accounting format for territories within the region should direct attention to the collecting of data on these important gaps in our financial statistics.

Residuals are to be expected in almost any presentation of statistics, but the failure to allocate items efficiently leads to frequent occurrence of large residual items. This defect creates problems for interpretation, since the nature of the residual item is often unstated. The implication for financial accounting in this connection, is that more effective allocation of items cannot be accomplished, until more knowledge

on the operation of the financial sector is acquired.

A comprehensive set of financial statistics cannot be developed overnight. Financial accounts should start from readily available, accurate data. The expansion of the accounts should be dictated by the availability and the relative reliability of further information. If properly organised, the data incorporated into the accounts can provide further information on the activities of the sectors for which no information is available. One question that arises out of this exercise, is what advice should be given to the smaller territories of the region which have not yet devised systems for the collection of general purpose data, or data for specific purposes. What kind of data are apt to be most useful in facing the problems associated with planning with economic development. There is no clear-cut answer to these questions. There should be special interest in the financial structure of the economy, data on the money supply since the near-money substitutes which provide additional liquidity are of much less importance than in the developed economies, data on foreign exchange holdings and transactions.

## OPERATIONAL PROBLEMS

Severe shortage of skilled personnel constitutes the major obstacle to the development and implementation of efficient procedures of financial accounting throughout the region. Competition with the private sector accentuates this problem. Within the E.C.C.A. member territories the problem seems to be more acute than in the rest of the region. It is obvious that one of the priorities to which attention should be directed in attacking the operational problems in the field of financial accounting, is the attracting and retention of individuals with the required skills.

Non-specialized production complicates the task of providing a more detailed analysis of "loans and advances" by financial institutions. For example, while it is suggested that within the region, bank loans and advances to "agriculture" could be further broken down into a number of sub-headings, commercial banks may be unable to provide these details, simply because the bulk of their loans were made to finance non-specialised activities. However, the idea behind the acquisition of more detailed knowledge on sources and uses of capital within the economy should not be abandoned, since such details considerably enhance our knowledge of the interaction between the financial sector and the rest of the economy.

The collection of specific financial data on the operations of insurance companies with head offices located outside the region is normally a long, drawn-out process. Much of the statistics published by the companies is so aggregative, that it provides little knowledge of its operations in any single territory. A break-through in reducing the

problems involved in acquiring knowledge of the operations of this type of institutions is essential, because they are among the major mobilisers of long-term capital within the system.

Situations may arise in which some compromise may have to be made on the publication of data. For example, if a single firm enjoyed a monopoly in one type of activity within any territory, in order to encourage co-operation with the authorities in the provision of statistics on its operations, the authorities might do well to consider the decision to withhold from publication statistics on the operation of monopoly institutions.

While it is desirable that an attempt should be made to compile statistics on trade credit, the administrative problems involved seem to be very complex. Within the region major sources of trade credit are commercial banks, hire-purchase companies, and foreign exporters. Much of this credit is controlled by the commercial banks, so that a squeeze on the commercial banks, will tend to reduce trade credit also. The situation is much unlike the developed economies, where the bulk of trade credit takes place outside the commercial banks. An attempt to compile trade credit statistics on the region seems to entail substantial administrative costs, because of the complex nature of its distribution.



CONCLUSION

Much of the previous analysis has necessarily been tentative because of the unavailability of financial statistics on the E.C.C.A. member territories. However, there seems to be no reason to suggest that the conclusions arrived at would be substantially altered if a wider and more recent coverage of financial statistics on Barbados, the Leewards and Windwards, was available for analysis. Certain common problems characterise financial accounting within the region, (1) crucial categories of data are not collected; (2) the excessive aggregation of financial statistics; (3) failure to disclose for independent analysis much of the collected statistics; (4) lack of meaningfulness of much of the collected data. These problems are the more acute in the smaller territories. Throughout the region they constitute effective barriers to efficient planning.

The view expressed by the<sup>9</sup> Radcliffe Committee on the organisation of statistics, is instructive for all engaged in the task within the region. We should hope that most or all of the additional statistics that we suggest will be furnished voluntarily by the institutions concerned. The exercise of compulsion tends not to be conducive to the collection of reliable statistics unless the statistics can be seen as necessary for some generally accepted administrative requirement. We recognize however that it may be necessary for the authorities to equip

<sup>9</sup> Radcliffe Report. Para. (857).

themselves with statutory powers to require financial institutions to furnish statistics, if only to reassure those who are already disposed to co-operate that their competitors will be under the same obligations as themselves.

Financial accounting within the region is devoid of any theoretical basis. Much emphasis should be placed on the selection of an appropriate theory of financial accounting before the task of compiling a comprehensive set of statistics begins. A theory is essential for the purpose of providing a proper framework around which the statistics can be organised. The importance of publishing as well as collecting financial statistics should be stressed because it is necessary that the basis on which decisions are made by the authorities should, so far as is consistent with public interest, be open to critical examination. The question arises, as to the best method of publication. Specifically, can any improvement be gained by altering the practice of the central-banking territories which publish main series in a single document, "A QUARTERLY DIGEST OF FINANCIAL STATISTICS"? There are drawbacks to such a course, since it might convey the impression that the only statistics relevant for purposes of financial analysis are those to be found within the pages of the "digest". The regular issue in a single publication of the categories of financial statistics which we have been discussing at an earlier stage of the analysis is to be strongly recommended. Many of the more important statistics are at present uncollected, or scattered in a number of sources to which it is not easy to refer. It is very likely that a single major publication would be useful to a large number of readers interested in different aspects of the financial system.

It will be of great value to the authorities themselves to possess a common body of statistical information, which is something they do not at present possess.

It is obviously necessary for the authorities to be able to keep under review the total impact of the whole group of financial institutions on the economy. As current trends in the literature indicate, though banks are the single most important suppliers of credit within the economy, there are within the system, other institutions which are of critical importance in the process of transforming the economic system. Knowledge of the capital structure of assets of financial institutions, as far as possible at market values, and the current flow of funds from the entire financial sector to other sectors of the economy is essential.

This requires the collection of statistics from the various financial institutions in a form which would enable them to be combined in terms of common categories of assets, for the same period and point in time. It is towards the preparation of a consolidated statement for the entire financial that the authorities should work. This requires considerable effort in improving the comparability and completeness of the statistics supplied by the different institutions, but justifies the cost involved because of the vast gaps in our knowledge on the operation of the financial sector, which such a research effort can fill.

A P P E N D I X

LIQUID ASSETS OF COMMERCIAL BANKS AND DETERMINING FACTORS

TABLE 2  
Bank of Guyana Annual  
Report 1966

ITEMS	Meaning of signs in relation to changes	Change during Period				
		1966	Quarters of 1966			
			1st	2nd	3rd	4th
	+ for determining factor:		expansion of liquid assets			
	for liquid assets:		increase			
	- for determining factor:		contraction of liquid assets			
	for liquid assets:		decrease			
<b>I. Determining Factors</b>						
1. Government net position with local banking system	+ increase) - decrease) 1) of net indebtedness	+ 11,545	+ 3,884	+ 1,709	+ 5,429	+ 523
2. Balance of payments	+ increase) - decrease) 2) of foreign reserves	- 12,065	- 5,265	- 2,014	-10,068	+5,282
3. Note and coin circulation outside banks	+ decrease) - increase) in circulation	- 143	+ 1,442	+ 1,425	- 498	-2,512

4. Deposits of non-banks with Central Bank	+ decrease) - increase)						
5. Commercial Bank's holdings of Government Securities	+ decrease) - increase)	of holdings	- 2,000	+ 4	- 2,041	+ 12	+ 25
6. Advances of commercial banks to Government	+ decrease) - increase)	of advances	+ 6,128	+ 725	+ 5,403	-	-
7. Government deposits with commercial banks	+ increase) - decrease)	of deposits	- 4,457	-1,442	- 2,938	- 70	- 7
8. "Float" between Central Bank and Commercial banks	+ increase) - decrease)	of excess of figure of commercial banks over Bank of Guyana figure	+ 90	+1,025	- 1,234	+ 586	- 287
9. Other factors			- 1,650	- 612	- 354	- 174	- 510
Total of above factors = Change of liquid assets 6) of commercial banks			- 3,190	- 239	- 44	- 4,821	+ 1,914
of which							
(a) Cash in Hand			- 3,959	-5,434	+ 235	+ 795	+ 2,035
(b) Balances with Bank of Guyana			+ 5,516	+3,687	+ 2,348	- 2,306	+ 1,787
(c) Foreign Balances			- 6,706	- 477	- 1,658	- 4,321	- 250
(d) Local Treasury Bills			+ 1,959	+1,985	- 969	+ 2,601	- 1,658

- ) Change in net indebtedness of Government to Central Bank and commercial banks.
- ) Change in foreign balances of Central Bank and commercial banks.
- ) Other than Government.
- ) Difference in balances of commercial banks with Central Bank in statements of Central Bank and commercial banks for the same date.
- ) Fixed assets and other assets less capital and other liabilities of the Bank of Guyana.
- ) Excluding commercial bills eligible for rediscount.

A P P E N D I X

ANALYSIS OF BANK ADVANCES

Table 9  
Bank of Jamaica Bulletin -  
March 1968, Vol. VII

GROUP (Based upon the Business of the Borrower)	March 1967		December 1967		March 1968	
	£3000	% of Total	£3000	% of Total	£3000	% of Total
1. Government and other Public Bodies						
2. Credit and Financial Institutions						
3. Personal and Professional						
4. Agriculture and Fishing						
5. Mining						
6. Industry -						
(i) Sugar, Rum & Molasses						
(ii) Food, Drink & Tobacco						
(iii) Textile, Leather & Footwear						
(iv) Other Industry						
7. Building & Construction						
8. Land Development						
9. Distributive Trades						
10. Hotels						
11. Entertainment						
12. Public Utilities						
13. Other						

APPENDIX

COMMERCIAL BANKS DEPOSITS  
(Excluding Deposits from Banks)

Table II, 9  
Bank of Guyana  
Annual Report  
1966

End of Month	Total Residents and non-residents	Residents												
				Public Sector				Private Sector						
		Total	Total	Central Govt.	Local Govt.	Public Financial Institutions	Statutory Boards and Other Public Authorities	Total	Private Financial Institutions	Business Firms		Individual Customers	Other Customers	
									Total	Incorp.	Non Incorp.			
Total Deposits														
Demand Deposits														
Time Deposits														
Savings Deposits														