International Convergence Of Accounting Standards: The Case Of The Australian Foreign Currency Standard

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INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS: THE CASE OF THE AUSTRALIAN FOREIGN CURRENCY STANDARD

by

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Some problems with the international convergence of accounting standards: The case of the foreign currency standard

Abstract

For some time, there has been a push towards the harmonisation of accounting standards throughout the world. Given international trade in corporate securities and the growth of multinational companies, the harmonisation of accounting standards is clearly desirable. However, as this paper shows, full harmonisation is unlikely to be achieved. The reason for this is that accounting standards are not merely technical rules. They have economic consequences and, thereby, have political implications for both the preparers and users of financial statements. The fact that economic conditions vary from country to country, means that accounting methods that are acceptable in one country may not be acceptable in another. Standard setters must be attuned to prevailing economic conditions in their own country or they are likely to face resistance to the standards that are set.

This paper outlines the problems faced by Australian accounting standard setters in the development of the foreign currency translation standard. The focus of the paper is the debate over the treatment of translation gains and losses on monetary items. It shows that harmonisation of accounting standards may be compromised when one country faces a different economic climate to others.
Introduction

In an article in the March 1996 edition of Accounting Forum, “International Convergence of Accounting Standards”, the desirability of harmonisation of Australian accounting standards with those issued by the IASC was outlined (Kropp and Johnston, 1996). However, as this article will show, that may not always be a viable approach for Australian standard setters because of local economic conditions and the large number of groups that may have an interest in accounting standards and, therefore, attempt to influence their content and application.

Accounting standards have been demonstrated to have economic consequences for those who must comply with them (e.g. ZeIT, 1978). The conceptual framework, in SAC 2, also recognises a diversity of interested users of financial accounting reports viz resource providers, recipients of goods and services and parties performing a review or oversight function. Accounting standards have the potential to impact on these groups as well as on the preparers of financial reports. The result is, that there is potentially a very large, perhaps infinite, number of groups with an interest in accounting standards. While there may be similarities in the composition of interest groups throughout the world, local economic conditions are likely to be reflected in the debates concerning appropriate accounting methods for specified transactions. As will be discussed in the paper, research indicates that standard setters are influenced by formal submissions dealing with specific accounting standards. It is also possible that informal submissions, for example, through the press and personal contact such as telephone calls and private meetings can have an impact on accounting standards.

The development of the standard dealing with foreign currency translation provides evidence of the difficulties faced by Australian standard setters in achieving a standard consistent with pronouncements in other countries. The foreign currency standard is, arguably, one of the most controversial accounting standards in the albeit short history of the Australian standard setting process. The contentious nature of this standard is evidenced by the length of time between the issue of the first Australian exposure draft in 1973 and the issue of two standards, ASRB 1003 Foreign Currency Translation - Disclosure and AAS 20 Foreign Currency Translation, in 1985. In 1987, ASRB 1003 was withdrawn and replaced with ASRB 1012 Foreign Currency Translation. AAS 20 was subsequently amended to make it compatible with ASRB 1012. This paper will deal with the Australian approach to the treatment of foreign currency gains and losses which arise when exchange rates change between the time a transaction is entered into or recorded in the books of the company and the date of settlement. The treatment of gains and losses on translation of the accounts of a subsidiary will not be considered because the decision as to the treatment of subsidiary gains and losses is made once the translation method, either the temporal or current method, is determined. This was also a very contentious issue but will not be addressed in this paper.

The paper will take the following format. First, two major alternative treatments of foreign currency gains and losses on monetary items will be briefly outlined. A short history will be given of the professional and business support for each method including reference to the economic conditions prevailing at the time each method was predominantly in favour. This will be followed by a review of the submissions on the
various exposure drafts leading to the issue of AAS 20 and ASRB 1012. The apparent major factors giving rise to the selection of the immediate recognition method over the defer and amortise approach and the introduction of the concept of a qualifying asset will then be discussed. The paper will terminate with some concluding comments.

**Alternative treatments of foreign currency gains and losses**

The accounting treatment of foreign currency gains and losses has a long and chequered history that is testament to the controversy surrounding this issue and the importance of prevailing economic conditions at the time an accounting standard is set. The debate has largely centred on the immediate recognition approach as opposed to the defer and amortise method. In the struggle to reach consensus on the matter, the concept of a qualifying asset was introduced and, thereby added a third approach which permits certain gains or losses to be added to the cost of the asset and depreciated over its useful life. This innovation appears to be explained by what were argued to be unique economic circumstances facing Australian companies, in particular, that Australian companies are net borrowers of foreign currencies. The US counterpart, FAS 52 does not contain such a provision. Gains and losses on settlement of foreign currency transactions are recognised immediately in the profit and loss account. By contrast, IAS 21 *Accounting for the Effects of Changes in Foreign Exchange Rates* allows losses arising from a severe devaluation or depreciation of a currency where there is no practical means of hedging to be included in the cost of related assets. However, the Australian standard maintains that this is too permissive and restricts such treatment to qualifying assets (see AAS 20, Compatibility with International Accounting Standard IAS 21).

**Immediate recognition method**

The immediate recognition of gains and losses in the profit and loss account was favoured in the first Australian exposure draft on accounting for foreign currency transactions issued in 1973. ED 1973 recommended this practice as being the only method to provide "adequate accounting and disclosure". It is perhaps relevant that Kenley found this to be the dominant treatment of translation gains and losses in a 1974-75 survey of 93 Australian companies (Kenley, 1978, p.40). Furthermore, exchange rates at this point in time tended to be both more stable and favourable to Australian borrowers of overseas currencies than in subsequent years (Cooper, 1994, p.472). For example, in the wake of revaluations in the Australian dollar in 1971 and 1972, the financial press reported windfall gains to Australian companies arising from overseas loans repayable in foreign currencies. Gains of up to $1.5 million were reported by Hooker Corporation Ltd, Network Finance Ltd, Commercial and General Acceptance (Ingram, 1973, pp.15, 16), Weeks National Resources Ltd (Dawson-Grove, 1973, p.28), Consolidated Gold Fields Australia Ltd (Perkins, 1973, p.17), Newbold General Refactories Ltd (Hornstein, 1973, p.19) and Matheson and Co (Australia) Pty Ltd (*The Australian Financial Review*, 1973a, p.33). Lombard Australia Ltd reported a $6.5 million gain (*The Australian Financial Review*, 1973b, p.31). In addition, immediate recognition of gains and losses in the profit and loss account had support at the time in the USA in that FASB 8, issued in 1975, prescribed the immediate recognition method.
There was also qualified support in Canada for the immediate recognition approach. A report prepared in 1972 for the Canadian Institute of Chartered Accountants (CICA), *Translation of Foreign Currencies* (1972), recommended immediate recognition of gains and losses but only when the change in exchange rate is significant and it is reasonable to assume it will not reverse in subsequent periods (Parkinson, 1972, p.54). The rationale behind this restriction was that when exchange rates are subject to reversal, it is not possible to reliably estimate the ultimate gain or loss (p.55). By the 1980s, there was Australian support for this argument which is probably a reflection of the change in economic conditions brought about by the floating of the Australian dollar and other changes in the financial markets (these will be discussed in more detail later in the paper). This trend away from the immediate recognition of foreign exchange gains and losses gained momentum and saw it replaced, in some countries, with a more permissive approach allowing the deferral and amortisation of gains and losses.

**Defer and amortise approach**

The defer and amortise method was adopted in the CICA’s 1977 exposure draft and subsequent accounting standard issued in 1983. This approach was also supported by the International Accounting Committee in IAS 21 issued in 1983 and in the 1979 and 1983 Australian exposure drafts and AAS 20 Foreign Currency Translation issued in 1985. The major arguments in favour of the defer and amortise approach at this time appear to be based on Parkinson’s view that immediate recognition was only appropriate when exchange rate changes were expected to be permanent (1972, p.55). Given that exchange rates historically were subject to reversal, translation gains or losses may never be realised (p.57). However, deferral of exchange gains or losses until realisation would be to keep “readers of financial statements in the dark” and deny them information needed to predict results and assess management performance (p.57). The compromise solution was deferral and amortisation on a proportionate basis. The proportion allocated to each accounting period was to be determined by the likelihood of the gain or loss materialising. This in turn would generally be determined by the date of maturity of the item concerned. Hence, the closer the maturity date, the greater the likelihood of the gain or loss materialising and, therefore, the greater the charge to be made against profit or loss in accounting periods immediately prior to settlement. Should settlement not be expected until the distant future, the smaller the proportion of the gain or loss recognised.

A further justification for the adoption of the defer and amortise approach with regard to long-term monetary items in the 1979 and 1983 Australian exposure drafts and in AAS 20 in 1985 was that immediate recognition of gains and losses on such items “may cause undue fluctuations in the results reported from period to period” (ED 1979, paragraph 14). It was further argued in ED 1979 that unamortised exchange gains and losses had the characteristics of deferred revenue and deferred borrowing costs respectively (paragraphs 17 and 18). Unamortised exchange losses were to be classified in the balance sheet as intangible assets while deferred exchange gains would be shown as deferred revenue. This approach represented a direct reversal of the view expressed in ED 1973:
There is no logical accounting basis, such as matching costs with revenue, for deferring recognition and spreading gains or losses over future accounting periods (paragraph 18).

However, as indicated above, this about face on the part of the standard setters may well have been a reflection of prevailing accounting practice and economic conditions.

In general, having reached a peak in 1972, the Australian dollar subsequently declined relative to the world's major currencies (Minchin, 1986, p.48). This turn of events saw a consequential reporting of foreign exchange losses on overseas borrowings and translation of financial statements as evidenced by reports in the financial press. For example, for the year ended December 31, 1974, Ciba-Geigy Australia reported a foreign currency loss of $1,588,712 on Swiss franc loans. The loss resulted not only from the devaluation of the Australian dollar in September 1974 but also an increase in the Swiss franc (The Australian Financial Review, 1975, p.30). Robe River Ltd reported foreign exchange losses of $540,308 as a result of the devaluation of the Australian dollar relative to the US dollar. The loss related to foreign loans used to finance acquisition of fixed assets (The Australian Financial Review, 1976, p11). Similarly, in the six months to November 1976, BHP recorded a $20 million loss resulting from the devaluation of the Australian dollar relative to the US dollar (Byrne, 1977, p.17). As already indicated, Lombard reported a $6.5 million foreign currency gain in 1973. However, for the six months to March 31, 1977, Lombard reported a foreign currency loss of $987,000 on the valuation of foreign currency loans due to a fall in the value of the Australian dollar (Ogg, 1977, p.27).

It is little wonder that by the time the 1979 Australian exposure draft was issued, the defer and amortise method was already widely used by Australian companies, for example, BHP, Comalco, ICI, Hammersley Holdings Limited and Conzinc Riotinto of Australia Limited (Phillip, 1980, p.29). This trend continued into the 1980s. In a survey of the top 20 Australian companies (by market capitalisation) in 1985, Eddey found the defer and amortise option was the preferred accounting treatment of translation gains and losses at least with regard to long-term monetary items (p22). As noted earlier, immediate recognition of gains and losses had been the method of choice in the early to mid-1970s. However, the declining value of the Australian dollar relative to other world currencies helps explain the change in preferred method of accounting for foreign exchange gains and losses. The advent of the 1980s re-enforced the desire for a different approach with the institution of significant changes in the financial markets in Australia and internationally.

**The economic and political climate**

In December 1983, the recommendations of the Campbell Committee (Australia, 1981) were implemented beginning with the floating of the Australian dollar. In addition, the finance market was progressively deregulated. The floating of the Australian dollar saw an increase in speculative dealings in the belief that the dollar would appreciate against the US dollar. This increase in speculative activities did not necessarily provide the gains expected because the dollar did not appreciate to the extent that speculators
anticipated (Lovett, 1983, p.11). Furthermore, the 1980s saw the emergence of a progressively more sophisticated foreign exchange market throughout the world. This development not only increased speculation and volatility of exchange rates but lessened the depth and resilience of the foreign exchange market. In world-wide terms, trading on the foreign exchange market doubled from $US75 billion per day in 1979 to $US150 billion per day in 1985 (AP-Dow Jones, 1985, p.46). By August 1986, trading was estimated at $US200 billion per day. Australian dollar trade accounted for $A3 billion of this daily rate (Behrmann, 1986, p.26). This comparatively small proportion of Australian dollar trade suggests that Australian borrowers and traders would generally be required to denominate their dealings in a currency other than the Australian. It is not surprising, therefore, that arguments in favour of the defer and amortise method were put forward. For example, ED 1979 justified the deferral and amortisation of unrealised exchange gains and losses in respect of long term receivables and payables on the grounds that it provided consistent treatment of gains and losses, was prudent and did not distort results (paragraph 16). Furthermore, the defer and amortise method was claimed to provide appropriate matching of the cost of borrowed funds with the benefits arising from the use of those funds. To achieve this, any gains or losses on foreign borrowings were to be amortised over the period to settlement of the loan. Eddey further argued that for long-term monetary items the probability of a gain or loss being realised in a cash flow equivalent was not high enough to warrant immediate recognition in the profit and loss account of gains or losses when exchange rates were floating (1985, p.21).

From the time of the issue of ED 1979 until the revision of AAS 20 in 1987, much of the debate concerning the deferral and amortisation of gains and losses on foreign currency denominated loans appeared to centre on semantics rather than the merits of the approach. For example, ED 1979 defined “settlement date” for the purpose of amortisation of long term monetary items as:

... the date on which a receivable is, or is due to be collected, or a payable is, or is due to be, paid (paragraph 4 (g))

This was important because, as stated previously, ED 1979 permitted the deferral and amortisation of unrealised exchange gains and losses in respect of long term receivables and payables. The definition of “settlement date” was, therefore, pivotal to the application of the defer and amortise process. However, ED 1983 did not provide such a definition. ED 1983 continued to permit the defer and amortise option but qualified its use as applying to long term monetary items having “fixed or ascertainable lives” (paragraph 10). Exchange differences on such items were to be amortised on a “systematic basis over the remaining life of the monetary item”. The “remaining life of the monetary item” was not defined. This left open the possibility of never bringing exchange differences to account by rolling-over the debt.

The question of the treatment of foreign currency gains and losses on short term and long term monetary items featured strongly in the submissions received in response to ED 1983. These submissions are enlightening in that they suggest the validity of research undertaken by Coombes and Stokes (1985), Morris (1986) and Gavens, Carnegie and Gibson (1989) that standard setters are influenced by submissions received.
A total of 38 written submissions were received. With regard to short term monetary items, thirteen respondents considered gains and losses on short term monetary items should always be brought to account in the profit and loss account as incurred. Nine submissions disagreed. Two of these were qualified in that the respondents did not think gains should be brought to account. A third submission considered gains and losses should be included in the cost of purchases. This could be seen as a vote for the concept of qualifying assets introduced in AAS 20 and Release 406 Foreign Currency Translation. Fifteen respondents made no comment on this issue.

On the issue of long term monetary items, only ten respondents agreed that gains or losses should always be deferred and amortised over the remaining life of the relevant item. Twenty respondents disagreed but there was not universal agreement on how these items should be treated. The majority considered gains and losses should be recognised immediately. Two were clearly in favour of a flexible approach.

The third question addressed in ED 1983 appears to be what gave rise to the introduction of the concept of qualifying assets. It asked whether exchange gains or losses on short or long term monetary items should ever be included in the cost of the asset. This question was in direct contradiction of the exposure draft which maintained that the purchase of an asset and exchange differences arising from the financing of acquisition of those assets are two separate transactions. Therefore, exchange differences should not be included in the measurement of the relevant assets (paragraphs 8 and 10). Ten respondents indicated a preference for this treatment. Six disagreed while one wanted a flexible approach. The majority of submissions did not respond to this question.

One industry submission argued strongly for the inclusion of gains and losses on long term monetary items to be included in the measurement of an asset which has been financed by overseas borrowings if the relationship between the two could be positively identified. The basis of the argument was that if interest on overseas borrowings could be capitalised up until the commencement of production, then gains or losses on overseas borrowings should also be capitalised and amortised over the life of the project. This argument appears to have been persuasive as the concept of qualifying assets was introduced in AAS 20 and its ASRB identical twin, Release 406, and became firmly entrenched as part of accounting for foreign currency transactions.

In response to Release 406, the ASRB collated 39 submissions. Of these, a total of 35 submissions were actually analysed. Of the remaining four, two submissions were missing and two recorded in the 39 figure were duplicates. From a review of these submissions, the most contentious aspect of Release 406 was the definition of "settlement". Unlike ED 1983, which permitted the amortisation of gains and losses over the life of the monetary item, Release 406 required any unamortised gain or loss on long term monetary items to be brought to account in the determination of profit or loss in the year in which "settlement" occurred (clause 13). The Release 406 definition of settlement was more detailed than that incorporated in ED 1979 but was more permissive in that it continued the implication of ED 1983 in that rolling over of the debt avoided the necessity to report any gain or loss. Release 406 defined settlement as
(i) extinguishment by repayment (in currency or otherwise), except where the monetary item is immediately rolled over within an existing formalised credit arrangement containing a firm commitment to continue to provide funds at least equal to the amount of the monetary item rolled over; or,

(ii) remission; or

(iii) uncollectability (of a receivable)

While part (i) of this definition meant that the defer and amortise option was available where a loan was rolled over, it could not be used where there was a renegotiation or re-financing of debt. This was apparently a departure from the restrictive release exposure draft of AAS 20 issued for confidential comment in April 1985. According to one submission, the definition of settlement in that draft included "reconstruction by renegotiation of terms".

Of the 35 submissions, 19 rejected the Release 406 definition of settlement and argued that a renegotiation or re-financing of debt should be treated in the same manner as a rollover. In general, those who disagreed with the definition of settlement and the treatment of unamortised gains and losses which flowed from it, considered that the new facility should continue to be amortised. There was some disagreement over the appropriate period of amortisation but the most favoured time span was over the shorter of the original and new life of the monetary item. The major arguments presented in favour of this approach centred on economic consequences and commercial reality. Many respondents argued that the international market was becoming increasingly sophisticated and a wide variety of credit arrangements and facilities were emerging. The provisions of Release 406 were likely to deter management from taking advantage of alternative credit facilities offering lower interest rates because of the impact on the profit and loss account of bringing unamortised gains or losses on the old arrangement to account. In addition, some respondents considered Release 406 would limit access to major sources of capital as well as increase the cost of borrowing.

Some respondents noted that the standard made no attempt to justify the defer and amortise method and failed to provide detailed guidelines on the amortisation method to be used. It was also noted that the defer and amortise method is a form of income smoothing. Others, however, argued that while the immediate recognition of gains and losses on long term monetary items was prescribed by accounting standards in the USA and UK, it was not valid in the Australian situation because Australia is an importer of capital and the Australian dollar was a minor currency on world markets. Both of these factors put Australian companies in a different position to companies in the USA or the UK. Hence, while harmonisation of standards throughout the world may be desirable, local conditions may necessitate differences from country to country.

AAS 20, which was identical to Release 406, also attracted attention. In The Chartered Accountant in Australia of June 1986, the definition of "settlement" in AAS 20 was the subject of discussion by John Miles, chairman of the Accounting Standards Board (Miles, 1986). As discussed in relation to submissions in response to Release
406, more than half of the respondents wanted this definition modified to include renegotiation or re-financing of debt as well as rollovers. According to Miles, the rollover exception in the definition of settlement was included “following a number of submissions (1986, p.31). It seems, however, that the AARF had backed away from an even more permissive approach which would have extended the rollover exclusion to renegotiation of terms of loans. The renegotiation of terms was part of the definition of settlement in the exposure draft of AAS 20 restrictively circulated for comment in April 1985 (Submission on Release 406). Miles did not provide explicit details of why the renegotiation exclusion was dropped. Some of the problems with the rollover exclusion were outlined which help explain the AARF's reluctance to extend the exclusion to renegotiation or re-financing. These problems included the possibility that the rollover may be in another currency, another facility, with another lender and may not follow immediately after settlement of the original debt (1986, p32). As the analysis of submissions on Release 406 has already indicated, commercial reality was a common ground for extending the rollover exclusion to renegotiation and re-financing. Miles acknowledged the arguments appeared reasonable but there was no simple answer (1986, p32). The picture was further clouded by the fact there was no clear consensus as to the treatment of foreign exchange gains and losses on long term debt. However, the view towards "settlement" adopted by the Accounting Standards Board appears to have been that while the defer and amortise option was justified in terms of the matching concept, it was more difficult to extend the argument to what was effectively a new loan (Miles, 1986, p32).

A lobby of 14 companies headed by Western Mining Corporation approached the AARF in a bid to have the "settlement" definition extended but failed (Newsitems, 1986, p18). The Accounting Standards Board maintained there was no precedent for the treatment of renegotiated or re-financed loans in the accounting standards of other countries or in terms of generally accepted accounting principles dealing with realised gains and losses (p19). This is a valid attitude but it casts some doubt on the AARF's adherence to the defer and amortise approach which had only marginal support in international accounting standards.

The introduction of the concept of a qualifying asset in AAS 20 and Release 406 appears to have slipped in unnoticed and unchallenged. Considering the AARF's approach to the renegotiation or re-financing issue, the inclusion of the concept of a qualifying asset is mystifying. It also had no precedent in other accounting standards dealing foreign currency transactions.

The Demise of the defer and amortise approach

During 1986, the vagaries of the foreign exchange market and the losses incurred by companies were beginning to raise questions about the propriety of the defer and amortise approach. An article in the Business Review Weekly of August 29, 1986 highlighted the inherent problems with the deferral and amortisation of gains and losses on foreign debt (Thomas, 1986, p125). The article reported that Alcan Australia had written-off $69 million of its unamortised foreign exchange losses incurred on overseas borrowings. Comments by Alcan's finance controller support the view expressed that
the defer and amortise approach permitted management to conceal increasing foreign exchange losses:

Our treatment may well bring into the open a problem among companies that previously has been hidden away (cited by Thomas, 1986, p125).

Thomas went on to note that in terms of the defer and amortise approach, AAS 20 was not consistent with UK and US standards and was

... looking increasingly controversial, especially with many big companies about to enter a recessionary phase with their balance sheet strength already eroded by injudicious overseas funding (p125).

In September 1986, another journalist, Doug Jukes, described AAS 20 as a "lenient standard" because it permitted the deferral and amortisation of unrealised losses which was "out of kilter" with overseas practice where gains and losses on long term monetary items are written-off as incurred (1986, p144). Jukes also claimed "confusion reigns" because some companies were writing-off the "now common" losses to clear the deck so to speak before AAS 20 became operational at October 31, 1986 (p144). There would have been less confusion if all companies were using the same method but this was not the case. Alcan wrote its losses off to reserves (Thomas, 1986, p125; Jukes, 1986, p146). Other companies, including CRA, Comalco and CSR wrote-off losses through the profit and loss account but did not include them in operating profit. Santos capitalised $286.5 million in deferred exchange losses by including them as a component of investments (Jukes, 1986, p146).

While AAS 20 continued to be binding on members of the professional bodies, the ASRB was not prepared to accept it as an approved accounting standard without further deliberations and consultation with interested parties. In December 1986, Release 411 Foreign Currency Translation - Key Issues Questionnaire was issued. Responses were requested by 2 February 1987. The questionnaire addressed nine issues including the treatment of unrealised and realised foreign exchange gains and losses and the definition of settlement.

A total of 36 submissions was received. Six submissions were confidential leaving 30 submissions for analysis. In response to the question of treatment of unrealised gains and losses, one submission did not address this issue. A total of 9 respondents supported the immediate recognition approach although 5 respondents qualified their response. The major exceptions being that immediate recognition should not apply where transactions were hedged or in respect of qualifying assets.

Twenty submissions supported the defer and amortise approach. Of these twenty, six considered there should be a measure of flexibility such as the adoption of immediate recognition where there is a major and permanent realignment of the Australian dollar. Some companies were already adopting this approach which was also consistent with AAS 20 paragraph 11.
The question regarding the treatment of unrealised gains and losses also asked how "settlement" should be defined. This issue was important because the definition excluded rollovers and, by implication, included renegotiation and re-financing of loans. This meant that where a loan was renegotiated or re-financed, any unamortised gains or losses were to be taken immediately to the profit and loss account. Four submissions did not address this issue. Of the remaining submissions, 11 supported the AAS 20 definition while 15 considered renegotiation and re-financing should be treated in the same manner as rollovers.

Early in March 1987, the ASRB held a meeting with what was described as "a select group of respondents" to Release 411 (Killen, 1987a, p14). This select group included BHP, Westpac Banking Corp, CRA, MIM Holdings, the Securities Institute of Australia and Price Waterhouse. The purpose of the meeting was to discuss contentious issues arising out of accounting for foreign currency transactions (Killen, 1987a, b) in particular, the defer and amortisation method and definition of settlement.

ASRB Media Release 87/1 - The Saga Ends

On April 3 1987, the ASRB issued Media Release 87/1 which requested the profession-sponsored AARF resubmit a foreign currency standard providing for immediate recognition of gains and losses on long term monetary items. The Media Release stated its decision was based on consideration of international accounting standards, especially those of the USA and the UK and submissions received in respect of Release 411 and at the discussion forum held in March (ASRB 1987a, p1).

Given what it saw as a lack of consensus on the defer and amortise issue, it appears the ASRB may have effectively skirted the definition of settlement issue by opting for the immediate recognition method. Again, there was no clear consensus as to what constituted "settlement" but if the definition was to remain or be extended to renegotiation or re-financing, there would be even more scope for manipulation of accounts. In the extreme, gains or losses may never be brought to account.

In a bid to counter the possible backlash from companies with substantial unamortised gains or losses, Media Release 87/1 stated that the eventual approved standard would provide for the writing off of unamortised losses against the opening balance of retained profits (ASRB 1987b). Media Release 87/1 also stated that, subject to the consequences of the adoption of the immediate recognition approach, the requirements of the approved standard would be the same as AAS 20 (p2). This meant that gains and losses on hedges relating to specific commitments and qualifying assets would be capitalised and would not be subject to immediate recognition in the profit and loss account.

In addition to the ASRB's call for submissions, the AARF was also taking action on the defer and amortise issue. The Accounting Standards Board of the AARF met late in March to discuss proposals put forward a week earlier by the ASRB (Killen, 1987c, p.14). The AARF also issued a press release calling, inter alia, for submissions on the ASRB's proposals to drop the defer and amortise method of accounting for long term monetary items. The number of submissions or comments received in response to the
AARF's press release, 74, is testament to the contentious nature of the issues it raised, in particular, the defer and amortise issue.

Of the 74 responses, four were either classified as confidential or a non-response. This left 70 submissions to be analysed. Of the 26 submissions expressing agreement with the immediate recognition of gains and losses on long term monetary items there were individuals (5), companies (4), academics (4), government authorities (3), accounting firms (3), banks and bankers' associations (3), other (20), professional associations (1) and regulators (1). Four of these respondents, however, did not give unqualified support. Two respondents would have preferred a more flexible approach but if this was not an option, immediate recognition was preferred over the defer and amortise approach. The third submission expressing a qualification to immediate recognition accepted this approach in order to have consistency between the profession's standards and those of the ASRB. A fourth qualifier stated that the choice of method was irrelevant to them but they did have a preference for the immediate recognition method.

Thirty-five submissions preferred the defer and amortise approach. These represented submissions from companies (12), government authorities (12), individuals (6), accounting firms (2), professional associations (2) and banks and bankers' associations (1).

Four of these respondents did not express unqualified support for the defer and amortise method. One expressed a clear preference for the defer and amortise method but recognised that the immediate recognition approach had the merits of being compatible with USA and UK accounting practice and avoided creative accounting. In addition, this respondent considered that where there was a major realignment of the Australian dollar which was expected to be permanent, unamortised losses should then be written off. This same view was expressed in response to Release 411. Two other submissions considered the defer and amortise method should only be applied where the company had hedged the relevant transaction. Another submission considered the gain or loss should be amortised over the life of the asset not the loan. A further submission, which was not included with respondents in favour of the defer and amortise approach, did not directly answer the question but implied support for this method.

Five submissions expressed a preference for a flexible approach whereby reporting entities could select the method appropriate to their own situation. Three submissions did not address the issue at all.

On September 30, 1987, ASRB Media Release 87/4 announced the approval of ASRB 1012 which was to apply to companies as of January 1, 1988 (ASRB 1987c). AAS 20 was re-issued by the AARF in December 1987. As expected, both standards prescribed the immediate recognition of gains and losses on long term monetary items except with regard to those relating to qualifying assets.
Concluding Comments

In the final analysis, harmonisation with the standards issued by the USA and UK was achieved to the extent that the immediate recognition of gains and losses is prescribed in AAS 20 and ASRB 1012 but the Australian standards still have the unique exception of qualifying assets. An explanation for the inclusion of this variation in the standard can only be inferred as no ‘official’ explanation is available. A likely explanation is that the concept of a qualifying asset was introduced as a result of lobbying activities by companies. For example, AAS 20 introduced the concept of a qualifying asset whereby gains and losses on foreign currency loans used to finance the purchase of assets was included in the cost of the asset. This was in direct contradiction to the separate transaction philosophy set forward in ED 1983 paragraphs 8 and 10. AAS 20 was subjected to restrictive circulation for comment prior to its release. It is impossible to determine whether this restrictive circulation was responsible for the inclusion of the qualifying asset provisions of the standard because the responses to this release were confidential and are not available for analysis. However, the provisions of AAS 20 and ASRB 1012 dealing with qualifying assets are almost identical to a proposal put forward in a submission in response to ED 1983. In addition, confidential hearings were held with select groups by both the ASRB and the AARF. It is also possible that non-publicised meetings were held between standard setters and interested parties.

The overall conclusion is that harmonisation of accounting standards throughout the world is highly desirable at a time when distance is no barrier to company formation and trade. However, standard setting is not merely a technical process. It is highly political and standard setters must be mindful of the social and economic consequences of standards. While it could be argued that harmonisation was achieved with regard to the immediate recognition approach, from the publicly available information, there was not an overwhelming preference for the defer and amortise approach even though the majority of submissions supported this view. The introduction of the qualifying asset approach may have been a compromise built into AAS 20 and Release 406 in anticipation of the eventual need to conform with overseas standards. In other words, the move towards harmonisation may have give way to local conditions in the form of variations or flexibility in standards.
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